

1        IN THE UNITED STATES DISTRICT COURT  
2        FOR THE WESTERN DISTRICT OF PENNSYLVANIA3        

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4        UNITED STATES OF AMERICA

5                       Plaintiff

6                       vs.                        Criminal Action No. 04-51E

7        GARY DEAN RHOADES

8                       Defendant

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10        PROCEEDINGS11        Transcript of Sentence commencing on Tuesday,  
12        June 21, 2005, United States District Court, Erie,  
13        Pennsylvania, before Honorable Maurice B. Cohill, Jr.,  
14        District Judge.

## 15        APPEARANCES:

16        For the Government:        US Attorney's Office  
17                                        By: Marshall Piccinini, Esq.18        For the Defendant:        Federal Public Defender  
19                                        By: Thomas Patton, Esq.20                                        Reported by:  
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22 Proceedings recorded by mechanical stenography. Transcription produced by computer-aided transcription.

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## 1 PROCEEDINGS

2 (Court reconvened on Tuesday, June 21, 2005, at 9:35 a.m.)

3 THE COURT: Good morning.

4 MR. PICCININI: Good morning, Your Honor.

5 MR. PATTON: Good morning, Your Honor.

6 THE COURT: Be seated, please.

7 This is the time set for the sentencing of

8 Gary Dean Rhoades. And we note that Mr. Rhoades and

9 Mr. Patton, his attorney, have signed the notice indicating

10 they have received and reviewed the presentence report.

11 We will make that part of the record and keep it

12 under seal. If an appeal should be taken, of course, counsel

13 on appeal would be permitted access to that report.

14 There has been no information withheld from the

15 defendant which was given to the Court.

16 I assume defense counsel received the impact

17 statement from the Venango County Commissioners that was

18 given to the Court?

19 MR. PATTON: We received the addendum to the report

20 which laid out the impact statement, and I believe we did

21 actually receive a copy of the impact statement, itself, as

22 well.

23 THE COURT: Okay. In wake of the recent decision

24 by the United States Supreme Court in United States against

25 Booker, 125 Supreme Court 738 issued in the year 2005, the

1 Sentencing Guidelines, of course, now are advisory only.

2 But, we are still obligated to consult them in determining

3 imposition of a reasonable sentence.

4 Therefore, it's necessary that the Court will

5 address the objections to the presentence report and resolve

6 any factual disputes regarding the guidelines on the record

7 just as we did before. But, we do have to consider the

8 guideline range in order to receive the advice, so to speak,

9 of those guidelines, or I guess I should say the guidance of

10 those guidelines.

11 And in addition to the Booker decision, after

12 calculating the applicable guideline range, we must consider

13 the factors set forth in 18 United States Code

14 Section 3553(a).

15 The government did not have any objections to the

16 presentence report.

17 The defendant has filed a position with respect to

18 the sentencing factors raising several objections.

19 So, Mr. Patton, we'll ask you at this time if you

20 would give us your position and then we'll hear from the

21 government.

22 MR. PATTON: Your Honor, the only objection that we

23 have that substantively affects the guideline calculation is

24 the issue as to whether or not the abuse of position of trust

25 enhancement should apply.

1        There were also some clarifications in some of the  
2 family history information that was in the presentence  
3 report. But, I believe the addendum acknowledges those  
4 corrections and that has been addressed. So, I believe all  
5 we are left with today is the issue of abuse of position of  
6 trust.

7        I have spoken with Mr. Piccinini about how we will  
8 proceed today. Since the abuse of position of trust is an  
9 enhancement in Mr. Rhoades' offense level, the government  
10 does have the burden of proof of establishing the abuse of  
11 position of trust enhancement applies.

12        And Mr. Piccinini has evidence that he wishes to  
13 present on that issue and I then have evidence that I wish to  
14 present.

15        THE COURT: Okay. We will proceed in that fashion.

16        MR. PICCININI: Thank you, Your Honor.

17        In addition to our witness testifying concerning  
18 that issue, rather than call him twice, he will also go into  
19 some other matters concerning the facts of the case that I

20 think are relevant for sentencing, and counsel agreed with

21 that as well.

22 Your Honor, at this time I would call Special Agent

23 Kelly Smith from the FBI.

24 THE COURT: Come forward and be sworn, please.

25 Would you stand and be sworn, please?

Smith - Direct

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1 \* \* \* \* \*

2 KELLY SMITH, having first been duly sworn, testified

3 as follows:

4 THE COURT: Would you have a seat, please, and give

5 us your name and spell your last name.

6 THE WITNESS: Kelly Smith, Special Agent with the

7 FBI. It's S-m-i-t-h.

8 THE COURT: First name is K-e-l-l-y?

9 THE WITNESS: That's correct.

10 THE COURT: Okay.

11 MR. PICCININI: Thank you, Your Honor.

12 DIRECT EXAMINATION

13 BY MR. PICCININI:

14 Q. Sir, how are you employed?

15 A. I'm employed as a Special Agent of the Federal Bureau of

16 Investigation.

17 Q. And how long have you been employed in that capacity?

18 A. Approximately three and a half years.

19 Q. In the three and a half years that you have been

20 assigned to the Erie FBI office, has there been a primary

21 focus in your investigative activity within the Erie office?

22 A. Yeah. The primary focus of my responsibilities include

23 the enforcement of what we typically call white-collar crimes

24 and federal law affiliated with that.

25 Q. And, Special Agent Smith, do you have a background that

Smith - Direct

7

1 would give you some reason why your agency has assigned you

2 to conduct these types of investigations?

3 A. Yes. Prior to my employment with the FBI, I was

4 employed as a certified public accountant with an

5 international accounting firm.

6 Q. And where were you employed with that accounting firm?

7 A. In Seattle, Washington.

8 Q. And what was the nature of your employment with that

9 accounting firm?

10 A. I was actually an auditor and typically I conducted  
11 financial statement audits. Different accountants in the  
12 firm had different responsibilities. Some were responsible  
13 for taxes. And my responsibilities mainly included financial  
14 statement audits.

15 Q. And for what period of time did you conduct financial  
16 statement audits for this international accounting firm?

17 A. Approximately September of 1997 to January of 2002.

18 Q. Now, were you also the case agent in the Gary Rhoades'  
19 investigation?

20 A. Yes, I was.

21 Q. Before we get into some of the details, if you can just  
22 explain generally, for the record, the nature of this scheme  
23 that Mr. Rhoades engaged in and whether it is similar to  
24 other schemes that have been seen across the nation?

25 A. Yes. The scheme that Mr. Rhoades used was what is

Smith - Direct

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1 typically known as a ponzi scheme. The person perpetrating  
2 the scheme will generally solicit funds from investors and  
3 then use those funds to solicit additional investors and use

4 the later investor's investments to pay off the investment to

5 the previous investors.

6        Essentially, instead of actually making some sort

7 of return on the investment, they are using principal

8 investments from later victims to pay off the earlier

9 victims. And eventually, as in this case, most of the

10 schemes begin to fall apart when they are unable to solicit

11 additional investors to pay off the original victims.

12 Q. In a nutshell, you are taking money from investors and

13 you use that same money to pay what appears to be principal

14 or interest to other investors to make them happy, to make it

15 appear that the investment is successful?

16 A. That's correct.

17 Q. In fact, is there any investment or any purchases of,

18 like in this case, certificates of deposit to support the

19 payments to other future investors?

20 A. In most ponzi schemes, there is not. And in this case,

21 there was not either.

22 Q. With regard to our two victims, the Northwestern School

23 District and Venango County, at least the two victims

24 identified in this particular indictment, was this a matter

25 of Mr. Rhoades funneling some of the Venango County money to

Smith - Direct

9

1 Northwestern School District and some of Northwestern School

2 District money back to Venango County to make it appear that

3 investments had been made for that?

4 A. Yes. During the period of this scheme, Mr. Rhoades

5 actually commingled all the funds. Once he received funds

6 from the investors, they were all grouped together. And then

7 he used that same pool of funds to pay out interest and

8 principal payments to Venango County, to Northwestern School

9 District, to make it appear that their investments were

10 maturing, were coming through and were making -- the dates of

11 those interest and principal payments were on the dates that

12 the supposed investments were due to mature.

13 Q. As far as setting up this particular scheme, were there

14 custodial agreements that were maintained between Mr. Rhoades

15 and a bank in Johnstown and -- between his victims, himself,

16 and a bank in Johnstown?

17 A. Yes, there were three custodial agreements. One between

18 Mr. Rhoades and the bank in Johnstown and Ameriserve

19 Financial Services, previously known as USBANCORP,

20 B-a-n-C-o-r-p, and then there was also the agreements between  
21 Mr. Rhoades, the school district and the bank, and  
22 agreements -- or an agreement between Mr. Rhoades, Venango  
23 County and the bank.

24 Q. Let me produce those particular agreements just so that  
25 they are entered into evidence in support of the sentencing

Smith - Direct 10

1 today.

2 First, I have marked as Government Exhibit 1 the  
3 Custodial Agreement between Gary Rhoades as the  
4 representative of RCM. What did RCM stand for?  
5 A. RCM stood for Rhoades Capital Management.  
6 Q. And this Government Exhibit 1, does this purport to be  
7 the custodial agreement between Gary Rhoades and USBANCORP?  
8 A. Yes. This is the Custodial Agreement between  
9 Mr. Rhoades and USBANCORP, and I believe we obtained that  
10 from USBANCORP through a grand jury subpoena.

11 Q. And the nature of this custodial agreement between  
12 Mr. Rhoades and Ameriserve, or USBANCORP, who was supposed to  
13 be the custodian and who was the principal for purposes of

14 this agreement?

15 A. The custodian was USBANCORP, which later became

16 Ameriserve, and the principal was Mr. Rhoades. And

17 Mr. Rhoades' responsibility, he was given the authority to

18 direct the investments, transfers transactions on behalf of

19 the county and the school district, and he was the one who

20 was to contact Ameriserve Financial and direct those

21 investments or those activities.

22 Q. So, Mr. Rhoades was the principal.

23 It was Mr. Rhoades that Ameriserve was acting as

24 the custodian on and as far as the terms of this first

25 agreement?

Smith - Direct

11

1 A. That's correct.

2 Q. And then, in addition, after having established his

3 custodial agreement with Ameriserve, did Mr. Rhoades then

4 take steps, likely at the direction of Ameriserve, to

5 establish custodial agreements for Venango County?

6 A. Yes, Mr. Rhoades entered into custodial agreements with

7 Venango County in much the same fashion where he was to act

8 as their principal or their agent.

9 Q. I will show you what I have marked as Government

10 Exhibit 2 for identification.

11 Does this appear to be the custodial agreement, at

12 least this custodial agreement entered into between Venango

13 County and Ameriserve?

14 A. Yes, it does. And this, again, was also obtained from

15 Ameriserve through grand jury subpoena.

16 Q. And in this particular custodial agreement, the

17 principal of this agreement is, in fact, Venango County, or

18 were they referred to as the investor for purposes of this

19 agreement?

20 A. Yeah. I mean, they are referred to as an investor, but

21 the same term would apply. You could use principal.

22 Q. And with regard to Mr. Rhoades' role now with regard to

23 his victims in this custodial agreement with Ameriserve, was

24 Mr. Rhoades the agent for the investor?

25 A. Yes. I mean, this one, it spells out clearly that

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12

1 Mr. Rhoades was, or RCM, Rhoades Capital Management, was the

2 agent of the investor and they were not aware of any other

3 employees of RCM other than Mr. Rhoades.

4 Q. So, this agreement number one, Mr. Rhoades is the  
5 principal for -- with Ameriserve as his custodian under RCM,  
6 in agreements number two and three, Venango County and  
7 Northwestern, Mr. Rhoades is the exclusive agent for the  
8 county and Northwestern School District for the purpose of  
9 being able to invest their funds?

10 A. That's correct.

11 Q. I will show you what I have marked as Government  
12 Exhibit 3 for identification, which purports to be the  
13 custodial agreement for Northwestern School District.

14 And is the custodial agreement for Northwestern and  
15 Venango County, are they both similar agreements as far as  
16 their terms, just one applies to Venango County and one  
17 applies to Northwestern School District?

18 A. That's correct. And on appearance, I believe these are  
19 both documents originally drafted by USBANCORP. It's  
20 probably a template document, if you will, and the wording,  
21 the funds are a little bit different and maybe they evolved  
22 over time but the wording is almost identical.

23 Q. In effect, by establishing both the custodial agreement  
24 with USBANCORP and separate custodial agreements as the agent

25 for Venango County and Northwestern School District, did

Smith - Direct 13

1 Mr. Rhoades have full authority over the funds into which are

2 placed, or the funds from which are placed into the

3 Ameriserve bank accounts?

4 A. Yes, he had full discretion over those funds and was

5 able to direct them in any way he saw fit.

6 Q. And that is because he had established himself as the

7 agent of the investor of the victims in this case?

8 A. That's correct. And presented himself as such to the

9 bank along with signatures of authority from the school

10 district and county authorizing him to act on their behalf.

11 Q. So, day one of this particular scheme, Mr. Rhoades is

12 set up through Ameriserve and the principal with them and as

13 the agent for the investors, Northwestern School District and

14 Venango County?

15 A. That's correct.

16 Q. Now, in the course of your investigation, did you

17 discover whether Mr. Rhoades had established any particular

18 history, in particular, with Venango County, as an investment

19 advisor?

20 A. Yes. As early as 1989, Mr. Rhoades had apparently  
21 assisted the county in some capacity with the issuance of a  
22 bond. One of the former county treasurers believed that he  
23 was employed by Mellon Bank at the time. It was somehow  
24 related to them -- we actually obtained documents from the  
25 county that showed that Mr. Rhoades was involved in this bond

Smith - Direct

14

1 issuance, but he was actually an employee of First Irwin --  
2 or Irwin Union Trust Bank and, you know, that was the  
3 earliest relationship with the county that we could document.

4 Q. Special Agent Smith, I am going to show you what I have  
5 marked as Government Exhibit 3 for identification.

6 Can you identify Government's 3?

7 A. Yes. This is the document I referred to, and the front  
8 page is a letter from Mellon Bank to the former Venango  
9 County treasurer, Margaret Spence.

10 Q. And in the caption, the actual -- the title of this  
11 particular letter and in the regard section, does it say on  
12 there \$4,240,000 certificates of deposit?

13 A. Yes, it does.

14 THE COURT: Excuse me. You referred to that as

15 Government Exhibit 3.

16 MR. PICCININI: Excuse me. Four, Your Honor. That

17 should be four.

18 THE WITNESS: Do you want me to change it?

19 MR. PICCININI: Yes, if you would.

20 Q. And here in Government Exhibit 4, is this a letter to

21 the Venango County treasurer where Mr. Rhoades is

22 specifically named?

23 A. Yes. This is a letter to the former treasurer, and

24 attached were some agreements that the treasurer was to sign

25 and return a copy to Mr. Rhoades, who was then the vice

Smith - Direct

15

1 president and manager of Irwin Union Capital Corporation.

2 Q. And here, all the way back in 1989, had Mr. Rhoades

3 established himself with Venango County as someone to whom

4 the county should turn for the investment of certificates of

5 deposit?

6 A. That's correct.

7 Q. And in addition to the Assistant Vice President of the

8 Public Finance Division of Mellon Bank referring to

9 Mr. Rhoades as the vice president of Irwin Union Capital for

10 purposes of investments, on page three of this document, does

11 Mr. Rhoades, in fact, sign as the vice president of Irwin

12 Bank & Trust Company?

13 A. Yes, he does.

14 Q. The specific dispatching instructions for purposes of

15 Venango County investing with him with Mellon Bank?

16 A. Yes, he does.

17 Q. And then as a follow up to the Mellon Bank and the

18 documents that were provided on July 10th, 1989, does

19 Mr. Rhoades, in fact, sign off on documentation concerning

20 his role as vice president and manager of New York Operations

21 for Irwin Union Capital Corporation?

22 A. Yes.

23 Q. To Mellon Bank?

24 A. Yeah. Mr. Rhoades wrote a letter to Mellon Bank signing

25 off as vice president and manager of Irwin Union Bank &

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16

1 Trust, and in the letter he actually guarantees -- it's a

2 guarantee of the credit quality of an FDIC or FSLIC

3 institution, that his bank's policy is actually to guarantee

4 that investment were that institution taken over for some

5 reason.

6 Q. So, back in 1989 Mr. Rhoades is assuring, through Mellon

7 Bank in documentation that makes its way to Venango County,

8 that if things that we invest in those banks go under, we

9 guarantee your investments?

10 A. That's correct.

11 Q. Now, after the 1989 time period where Mr. Rhoades

12 established a relationship, an investment relationship with

13 Venango County, did there come a point in time where members

14 of the county and the school district believed that

15 Mr. Rhoades had also been employed in the Finance Department

16 of the City of Erie?

17 A. Yes. It was apparent that Mr. Rhoades had been employed

18 at some point with the Erie County Finance Department, and I

19 believe there was some people, and I can't recall who, but

20 some people recalled that he was actually the Erie County

21 finance director at one time.

22 Q. And with regard to meeting with Mr. Rhoades for purposes

23 of future investments, was there a belief that Mr. Rhoades

24 was actually president of the Commonwealth of Pennsylvania

25 County Treasurer's Association Conference?

Smith - Direct

17

1 A. Yeah. The former Venango County Treasurer, Miss

2 Margaret Spence, actually believed that at one point

3 Mr. Rhoades was a guest interpreter at the Commonwealth of

4 Pennsylvania County Treasurer's Association Conference.

5 Q. After this Mellon Bank in Irwin Company Trust

6 relationship that he had established with Venango County, did

7 the members of Venango County and Northwestern School

8 District become aware of the fact that Mr. Rhoades went out

9 on his own, hung a shingle and became Rhoades Capital

10 Management as the president of that particular investment

11 company?

12 A. Yes, they were aware of that. And at one point, members

13 of the school district actually believed that he may have had

14 some relationship with an entity called Cadre, C-a-d-r-e, and

15 was some sort of entity that administered what was called the

16 Pennsylvania Liquid Asset Funds, essentially a money market

17 fund for school districts.

18 Later on, they found that that was not the case.

19 But, at one point they believed that Mr. Rhoades had some  
20 association with this company.

21 Q. So, that's the background of their knowledge and  
22 information concerning Gary Rhoades.

23 After having established these custodial agreements  
24 between his victims and Ameriserve, what steps did  
25 Mr. Rhoades take at Ameriserve to establish accounts in the

Smith - Direct 18

1 names of his victims?

2 A. Mr. Rhoades approached Ameriserve and actually opened  
3 two separate accounts, one for Venango County and one for  
4 Northwestern School District, to receive their -- what  
5 investment funds, if you will.

6 Q. Who opened these accounts? Was it the Venango County  
7 treasurer or the Northwestern School District finance  
8 director who went down to Johnstown and opened up bank  
9 accounts in their names?

10 A. No. These accounts were opened by Mr. Rhoades.

11 Q. And because Mr. Rhoades had established those custodial  
12 agreements, did he have the authority to open up accounts in

13 the names of his clients or victims?

14 A. As far as it pertains to Ameriserve, or then USBANCORP,

15 yes, he did.

16 Q. Now, in addition to having opened up accounts in the

17 names of Venango County and Northwestern School District, had

18 Mr. Rhoades had other established accounts which are numbered

19 with an R at the beginning of them, but numbered accounts

20 which he controlled through which money could be funneled?

21 A. Yes. Mr. Rhoades actually had numerous accounts, some

22 in the names of -- some that were for his use only. One

23 called the production account. One called the pool account.

24 But, he also had additional accounts for different

25 quasi or actual governmental entities that he had established

Smith - Direct

19

1 in the past.

2 Q. Now, by having the custodial agreements in place and the

3 accounts that he established in place, what was the nature of

4 the way in which Mr. Rhoades was able to get money into those

5 accounts which he ended up stealing?

6 A. Well, Mr. Rhoades would solicit the investments from the

7 county and the school district, and when he did that he would

8 quote rates and maturity dates for certain certificates of  
9 deposit. And those, after we analyzed the computer, it is  
10 apparent that he went to websites that would actually list  
11 rates for certificates of deposit and he would actually quote  
12 what looked to be real CD's that were offered.

13 And once the county or the school district decided  
14 on what they wanted to invest in, he instructed them to wire  
15 money to the accounts at Ameriserve, and specifically he  
16 would instruct the county to wire money to the account the  
17 that was under the name of Venango County. And for the  
18 school district, he would instruct them to wire money to the  
19 account under the name of the school district, and that's how  
20 he would receive the funds.

21 Q. So, Mr. Rhoades would tell the victims, hey, I got these  
22 CD's, these are legitimate banks, here are the percentages  
23 for those, if you want those, wire transfer funds into those  
24 accounts that I have established in your names?

25 A. That's correct. And he would also provide the FDIC

2 Q. Now, after having received the money wire transferred

3 into those accounts that he established, what would then

4 happen with the money in a very short timeframe?

5 A. Within a very short time period, usually the same day or

6 within the next day, Mr. Rhoades would actually transfer the

7 money out of the accounts held in the names of the victims.

8 So, either Venango County or Northwestern School District, he

9 would transfer those funds into the account that was called

10 the pool account which was strictly for Mr. Rhoades' use.

11 Q. And after having transferred the funds from the accounts

12 that he established for Northwestern and Venango County, what

13 would Mr. Rhoades do to let the victims know what happened

14 with their money after it was transferred out of the

15 accounts?

16 A. Mr. Rhoades would send an investment confirmation to his

17 victims detailing each CD, each financial institution named,

18 each -- their FDIC numbers, the investment date, the maturity

19 date, the rate of return, and those would be either faxed or

20 mailed to the victims.

21 Q. I am going to show you what I have marked as Government

22 Exhibit 5 for identification.

23 Can you identify Government Exhibit 5?

24 A. Yes. This would be one of the confirmations that

25 Mr. Rhoades sent. This particular one was sent to

Smith - Direct

21

1 Northwestern School District based on their investment of

2 November 25th, 1997, maturing June 15th of 1998. And this

3 was representative of each time that either the county or the

4 school district made an investment, Mr. Rhoades would send

5 them this confirmation.

6 Q. So, if the victims have a bank account in Ameriserve,

7 did Ameriserve send them bank account statements which would

8 show money came into their accounts and money was transferred

9 out of their accounts?

10 A. That's correct. The victims, both the county and school

11 district, received statements from Ameriserve, and those

12 statements would show the receipt of money and then the

13 almost immediate disbursement of funds out of the account.

14 Now that the school district or the county did not receive

15 statements other than their own particular accounts so they

16 didn't see that the money went to the pool account or any

17 other entity, they just saw it left their own account.

18 Q. But, after that bank account statement was saying to

19 them, saying that \$495,000 had been wired out of their

20 account, did they then receive from Mr. Rhoades something

21 similar to Government Exhibit 5, this document, showing that

22 he had invested \$495,000 in the CD's?

23 A. That's correct, they received this document.

24 Q. Does this provide the Court a good example of how

25 specific Mr. Rhoades was on his letterhead in naming

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22

1 specifically identified banks, where they are incorporated,

2 their particular FDIC numbers, the maturity date for the

3 investments, the term for those investments, the anticipated

4 rate of return and the amount of money that they had invested

5 with him?

6 A. Yes. Each of the investments -- following each of the

7 investments, the victims received a statement that this --

8 they were always in this form -- nearly all of them are

9 identical as far as the form and the detail.

10 Q. And then after having established on those custodial

11 agreements showing that USBANCORP was where the custodial

12 agreements existed, did he then write down on the bottom of

13 each of the investment confirmations that all of the assets

14 were held by the custodian, USBANCORP Trust Company in

15 Johnstown, Pennsylvania?

16 A. That's correct. And at one point, they started changing

17 to Ameriserve after the change of the name.

18 Q. Then during the course of the fraud, Government

19 Exhibit 5, what is this an example of?

20 A. This is a monthly statement.

21 Q. This is six. Excuse me.

22 A. Mr. Rhoades would periodically send monthly statements,

23 specifically to the school district, and these statements

24 would again have the same amount of detail as the investment

25 confirmation, but they would usually come at the end of the

Smith - Direct

23

1 month or the quarter or the year.

2 Q. As far as the school district, as far as them believing

3 that money had been invested by Mr. Rhoades, were they

4 actually receiving periodic interest payments from him during

5 the time period of the fraud?

6 A. Yes. The school district arrangement was that they

7 received interest payments on them, the principal CD's  
8 investments on a per month basis so -- and the amounts of  
9 interest that they were receiving would have been the correct  
10 amount had Mr. Rhoades actually entered into certificates  
11 of -- CD's.

12 Q. Taking some of the money from the Northwestern School  
13 District, or the principal from Northwestern School District,  
14 Mr. Rhoades was making these \$483.47 payments to Northwestern  
15 School District to make it look like they were getting  
16 periodic interest?

17 A. That's correct. And it would come in a monthly lump  
18 some. So, in this case, \$2,400.

19 Q. And then Government Exhibits 7 and 8 also with regard to  
20 Venango County, and Government Exhibit 7, was he sending them  
21 investment confirmation forms?

22 A. That's correct. Mr. Rhoades was also sending  
23 investments confirmations in almost the exact same format to  
24 Venango County.

25 Q. And that's what Government Exhibit 7 identifies?

1 A. That's correct.

2 Q. And then Government Exhibit 8, if they were not being  
3 paid interest up front, were they getting maturity reports,  
4 Venango County that is, claims by Mr. Rhoades as to what  
5 amount should be paid to them in interest when their  
6 investment matured?

7 A. Yes. That was -- Venango County received interest  
8 payments on the maturity dates of the CD's. So, instead of  
9 receiving -- for six-month CD's, for example, instead of  
10 receiving six monthly interest payments, they would receive  
11 one interest payment at the end of the six-month period.

12 Q. Now, prior to the period of time, '97 to 2004, that this  
13 indictment charged, was there a period of time where  
14 Mr. Rhoades used this particular scheme, what appeared to be  
15 successful investments, paid them back both principal, and  
16 what they believed to be principal and interest from their  
17 investments?

18 A. You mean other entities besides --  
19 Q. Well, Venango County and Northwestern first, and then  
20 whether there were other entities that appeared to have been  
21 paid off.

22 A. Yes. This scheme predated the time period in the

23 indictment. There were some payments to an entity called

24 West Chester Authority, which we later learned is a now

25 defunct water authority in West Chester, Pennsylvania.

Smith - Direct

25

1 Q. Let's use that as an example. In 1997, did Venango

2 County pay \$495,000 into -- transfer \$495,000 into their

3 account that Mr. Rhoades had established on their behalf?

4 A. I think you are actually referring to the Northwestern

5 School District being transferred 495,000. I believe that's

6 actually one of the exhibits, and that was in November of

7 1997.

8 Q. And very shortly after Northwestern School District put

9 in \$495,000, what did the account activity show Mr. Rhoades

10 did almost immediately with that money?

11 A. That very same day, Mr. Rhoades, or within the next day,

12 transferred the money to the pool account. And then, I

13 believe within three days, had transferred \$499,000 to the

14 West Chester Authority and that was, prior to the investment

15 of Northwestern School District, there was only about

16 approximately 30,000 in all of Mr. Rhoades' combined

17 accounts. Essentially, he immediately used the Northwestern

18 School District investment to pay West Chester Authority.

19 Q. And did we attempt to look further into whether West

20 Chester was a victim, and what did we discover?

21 A. At that point, we tried to locate West Chester

22 Authority, and at that point learned that it was previously a

23 water authority that is now defunct.

24 Q. So, as far as we can tell, we just know that Mr. Rhoades

25 used Northwestern School District's \$495,000 and cut a check

Smith - Direct

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1 out to West Chester Municipal Authority for payment for

2 whatever that happened to be for?

3 A. That's correct.

4 Q. And they likely would have been happy for this because

5 it appeared to them that they were paid off for whatever that

6 was, possibly an investment?

7 A. Right. Because from the period of November, 1997, to

8 now, it was clear that Mr. Rhoades was engaged in a ponzi

9 scheme and because of the funds used in this later investor,

10 Northwestern School District, was used to pay West Chester

11 Authority, one could reasonably conclude that the ponzi

12 scheme actually extended farther into the past.

13 Q. Now, in addition to this successful, what appeared to be

14 investments being perpetrated by Mr. Rhoades with his victims

15 over time, did it appear that both Venango County and the

16 Northwestern School District trusted Mr. Rhoades sufficiently

17 to actually roll over all their money instead of having

18 Mr. Rhoades cash it in and start with other investment?

19 Did they continually, during the period of this

20 particular indictment, roll over their funds until the end

21 when there were no funds left?

22 A. That's correct, because the county and school district

23 both were receiving interest payments, and sometimes

24 principal payments from their investments, they continued to

25 roll these over. Both of these are governmental entities and

Smith - Direct

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1 some of the monies is earmarked for capital projects. Some

2 is not needed in the short term. And as a CD would mature,

3 they would roll it over because they had no current use for

4 those funds and wanted to invest it to have additional funds

5 at a later date.

6 Q. And they started doing these roll-overs after what

7 appeared to be successful investments with Mr. Rhoades since

8 1997?

9 A. That's correct.

10 Q. Now, I put on the screen Government Exhibit 9 for

11 identification. And is this a chronology of investments that

12 you put together based upon the information that you obtained

13 in the investigation?

14 A. Yes, it is.

15 Q. And with regard to Venango County, does this show

16 Judge Cohill an original investment of a million dollars on

17 November 20 of 2000?

18 A. That's correct.

19 Q. And then when that was -- after that was supposed to

20 have matured, did Venango County roll over that particular

21 investment for another period for maturity?

22 A. Yes, it was rolled over. You can see it was actually

23 rolled over on three separate dates.

24 Q. Then when they believed that that investment matured,

25 had they rolled them over again?

1 A. Yes.

2 Q. Until October 14th, 2003, where a million dollars was  
3 supposed to be paid back to them?

4 A. That's correct.

5 Q. Likewise, with other funds, did they invest \$300,000?  
6 A. Yes. And then in July actually added an additional  
7 200,000 to that, the original 300,000.

8 Q. And then December of 2002 rolled that over?

9 A. Yes.

10 Q. And December 15th of 2003, that amount, that \$500,000  
11 investment, should have been paid off to them?

12 A. That's correct.

13 Q. The same thing with the Northwestern School District,  
14 did they start out in 1997 with that \$495,000 investment?

15 A. That's correct. And they also rolled that over. And,  
16 as time went on, actually received -- decided not to invest,  
17 roll the entire amount over and actually had some of their  
18 supposed CD's cashed out and returned to them so that in July  
19 of 2004, the outstanding amount was \$198,000.

20 Q. So, what happened at the end? What happened in October  
21 of 2003 and July of 2004 with regard to these victims getting  
22 their money back?

23 A. In October of 2003, the county had a telephone  
24 conversation with -- Mr. Rhoades contacted them and asked  
25 them if they would like to roll over their investment again.

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1 At that point, they told him no, that they would  
2 want the \$1,000,000.00 back. They never heard from  
3 Mr. Rhoades again. And then two months later, they were due  
4 an additional 500,000; did not hear from Mr. Rhoades.

5 At that point, our investigation began in late of  
6 October, 2003, and we learned of Northwestern School District  
7 also being a possible victim and I think they may have been  
8 contacted by the bank prior to our contact. And they also  
9 attempted to speak with Mr. Rhoades to obtain some assurances  
10 about their funds and they could not contact Mr. Rhoades  
11 either.

12 Q. He never called them back?  
13 A. No. And they left repeated messages with him to the  
14 point where his voice mailbox was full and couldn't leave  
15 messages.

16 Then they would call a few days later and it would

17 be cleared out. Again, they would leave more messages. Then

18 it would fill up again.

19 Q. Your investigation showed that the money was just gone?

20 A. That's correct.

21 Q. During this timeframe, were there auditors that had

22 already been engaged by the county and the Northwestern

23 School District to regularly audit the finances of both the

24 county and the school district?

25 A. That's correct. As governmental entities, they were

Smith - Direct

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1 both required to have financial statement audits.

2 Q. And in your experience as an auditor with this type of

3 audit, what is the nature of the audit? What is the audit

4 trying to do?

5 A. A financial statement audit is trying to detect if the

6 financial statements and records of the county and the school

7 district are free of material misstatement. The audits are

8 specifically not designed to detect fraud.

9 However, if an auditor were to find that, they

10 would notify their client. But, those audits are designed to

11 make sure there aren't omissions in the financial statements,

12 there aren't errors or irregularities.

13 Q. In the course of an audit, how much of an audit is based

14 upon the accuracy of the information being provided by the

15 audit, the entity? How much is the accuracy of the audit

16 based upon how accurate the information is?

17 A. There is a significant reliance on the accuracy of the

18 data provided to them. And the accuracy, honesty,

19 truthfulness of the management, in this case Northwestern

20 School District and the county, their honesty with the

21 auditors.

22 Typically, an audit would include what's called a

23 representation letter where the people responsible for the

24 financial records actually sign a letter stating that they

25 have been truthful, forthright and that they agree to be so

Smith - Direct

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1 during the course of the audit.

2 Q. I am going show what I have marked as Government

3 Exhibits 10 and 11, if you would just identify them, and they

4 purport to be documents, standard form confirmations to

5 confirm account balances, Exhibit 10 from Root, Spitznas &

6 Smiley, and then also audit documents from McMahon, O'Polka,

7 Guelcher and Associates, the auditor for Venango County.

8 Can you identify, just for the record, those two

9 documents?

10 A. Yes. The first document, Exhibit 10, is what's known as

11 a confirmation. This was sent by the accounting firm of Root

12 Spitznas, S-p-i-t-z-n-a-s, & Smiley, S-m-i-l-e-y, Inc. These

13 are the auditors for the school district. And they sent this

14 confirmation to Mr. Rhoades and to confirm the certificates

15 of deposit that Mr. Rhoades was supposed to be holding on

16 behalf of the school district.

17 Q. So, on this audit form, is Mr. Rhoades asked to confirm

18 the existence for the auditor, the existence of what appears

19 on the second page of this document the series of supposed

20 purchases of CD's he made with various banks?

21 A. Yes. The auditors attached a document to this that

22 details the institution offering the CD, a docket, account

23 cusip number, an interest rate and a fair market value as of

24 June 30, '99. June 30 is the fiscal year ending of the

25 school district.

1        You will notice on this particular one, it's more  
2    than the 495,000 and that is because, other than the  
3    investments that we showed, there were also additional  
4    investments made by the county and school district for which  
5    Mr. Rhoades paid out and so those did not become part of our  
6    indictment, but those investments also were not truly  
7    invested in certificates of deposit.

8    Q. As far as the victims knew, they were because they had  
9    been paid principal and interest, but you know that  
10   Mr. Rhoades had never purchased certificates of deposit  
11   during the period of the fraud?

12   A. Right.

13   Q. And then, given the opportunity to confirm or deny the  
14   existence of these purchases, Mr. Rhoades, in the front of  
15   this standard form to confirm account activity, lied and  
16   signed that he, as the president, as written on there  
17   July 28, 1999, that the investment had, in fact, been made?

18   A. Yes. He confirms that the information provided from the  
19   auditors is in agreement with his records.

20   Q. And then Government Exhibit 11, is it similar, although  
21   not the standard form, similar document from McMahon,

22 O'Polka, Guelcher and Associates, where they are soliciting

23 from Mr. Rhoades, the person that established these CD's,

24 confirming with him that the CD's had actually been

25 purchased?

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1 A. Yes. This is a different format, but it serves the same

2 purpose, that the auditors McMahon, O'Polka, O-'-P-o-l-k-a,

3 Guelcher, G-u-e-l-c-h-e-r, and Associates, Inc., sent this

4 letter to Mr. Rhoades and attached the actual investment

5 confirmations, and they sent this to Mr. Rhoades to make sure

6 that this was in agreement with his records.

7 Q. On page two of Government Exhibit 11, given the

8 opportunity to confirm or deny the existence of these

9 investments with Venango County, once again, Mr. Rhoades

10 lies, June 13, 2000, as the president of RCM and, in fact,

11 said the investments have, in fact, been made?

12 A. That's correct.

13 Q. Now, Special Agent Smith, did you have the opportunity

14 to put together kind of a spread sheet for the Judge to see?

15 Government Exhibit 12, does this provide kind of a

16 diagram for the Judge as to how Mr. Rhoades utilized various

17 bank accounts, previously established ones, and ones that he

18 created to funnel these funds?

19 A. Yes. This actually is a representation of the transfer

20 of funds. You can see the Venango County account, ROO13,

21 that is the account number, and the Northwestern School

22 District, ROO12, those were accounts held at Ameriserve. And

23 all of the bolded accounts were held in Ameriserve.

24 You can see the banks below actually listed, the

25 banks the county and the school district were using. And so

Smith - Direct

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1 the transfers to ROO12 would come out of either an investment

2 into their account at Ameriserve or a maturity, or interest

3 payout out of their account in Ameriserve would come from the

4 account that's titled in their own name.

5 However, previous or prior to or subsequent to that

6 investment or payout, the true source of the funds was

7 account ROO11. So, an investment in would only pass through

8 ROO12 and an investment out would only pass through that

9 account.

10 Q. And after Mr. Rhoades funneled the money from -- had the

11 money transferred from the county's actual accounts into  
12 their Ameriserve accounts and then up into his pool account  
13 and his production account, into what account did Mr. Rhoades  
14 transfer those funds that were supposed to be for the  
15 purchase of CD's?

16 A. Mr. Rhoades then transferred the funds into his own  
17 personal account at Fleet Bank. You can see there actually  
18 were transfers that were initiated both out of the production  
19 and pool account, although approximately, I think, 967,000  
20 came from the production account and only 6,000 from the pool  
21 account.

22 So, he utilized the production account on a much  
23 more frequent basis.

24 Q. Then did you have the opportunity to dig deeper and find  
25 out what happened to the money once it went from Ameriserve

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1 into Mr. Rhoades' own personal Fleet Bank account?  
2 A. Yes. After the money left Ameriserve and came to Fleet  
3 Bank, there were several different destinations of the funds.  
4 Q. I am going to -- hold on a second. I am going to show  
5 you what I have marked as Government Exhibit 13.

6 MR. PICCININI: And if you can hand that up to the

7 Judge. I apologize, Judge. I thought that your screen --

8 THE COURT: This screen is out of commission.

9 Q. On Government Exhibit 13, at the top of the particular

10 exhibit, does that show the Ameriserve account, the pool and

11 production accounts into which Mr. Rhoades put the victims'

12 money?

13 A. That's correct. That represents a conglomerate of the

14 Ameriserve accounts.

15 Q. And during the period of the fraud, did he transfer

16 \$973,500 into his own personal Fleet Bank account?

17 A. That's correct.

18 Q. And then what happened with the money from there?

19 A. Approximately 375,000 left the account in checks either

20 made payable to Gary Rhoades or cash. We noticed that a lot

21 of those had been negotiated at Richwood Banking Company.

22 And, you know, we saw retail debit card purchases and ATM

23 transactions coming out of Richwood Banking Company.

24 Approximately \$145,000 were withdrawn from ATM's.

25 Approximately \$388,000 was used to pay American Express bills

1 both in accounts under Gary Rhoades' name and under Catherine  
2 Rhoades' name, his then wife. Another 9,000 was in checks  
3 payable to either Catherine Rhoades or Carrie Transki.  
4 Transki is Rhoades' stepdaughter, I believe.

5 Q. So, from the nature of your -- from the results of your  
6 investigation, it appears that all of the \$973,500 during the  
7 period of this fraud that Mr. Rhoades stole from his victims,  
8 he spent almost every dime of it?

9 A. Almost, yes. Or we can't, you know, track down every  
10 dime, but it appears that almost the majority of it has been  
11 expended.

12 Q. Now, with regard to the amount of money that Mr. Rhoades  
13 took from his victims, the principal that the school  
14 district -- excuse me -- that the principal that both  
15 Northwestern and the Venango County folks invested with him,  
16 would that be the amount of \$1,698,000?

17 A. That's correct.

18 Q. And then as far as the interest that they anticipated  
19 receiving from Mr. Rhoades with regard to the Venango County,  
20 would that have been around \$25,100?

21 A. That's a very close approximation, yeah.

22 Q. And then with the Northwestern School District, should

23 they have also received \$5,468 in interest in addition to the

24 principal back from Mr. Rhoades?

25 A. That's correct.

Smith - Cross

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1 Q. And the total, therefore, is about \$1,728,568 that this

2 man stole from these victims?

3 A. That's correct.

4 MR. PICCININI: That's all I have, Your Honor, and

5 I would request the admission into evidence of each of the

6 thirteen Government's Exhibits.

7 THE COURT: Government Exhibits 1 through 13 are

8 admitted.

9 Miss Davis, has Government Exhibit 13 been

10 admitted?

11 MS. DAVIS: It has, Your Honor.

12 MR. PICCININI: Thank you, Your Honor.

13 MR. PATTON: Your Honor, I need a copy of

14 Government Exhibit 2, which is the custodial agreement,

15 because I am going to be asking the agent some questions

16 about that.

17 THE COURT: There you go.

18 CROSS-EXAMINATION

19 BY MR. PATTON:

20 Q. Agent Smith, you had testified that you have some

21 experience doing audits?

22 A. That's correct.

23 Q. And is it accurate to say that you worked as a certified

24 public accountant for a little over four years?

25 A. That's approximately, yes.

Smith - Cross

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1 Q. And then after those four and a half years is when you

2 became employed with the FBI, is that correct?

3 A. Correct.

4 Q. You had testified about the custodial agreement that was

5 entered into between Venango County and what I am going to

6 just refer to as Ameriserve.

7 A. Okay.

8 Q. And that is Government Exhibit 2.

9 A. Okay.

10 Q. Is it fair to say that this was a virtually identical

11 custodial agreement between the Northwestern School District

12 and Ameriserve?

13 A. Yes.

14 Q. And under that agreement, Mr. Rhoades was appointed the

15 agent of the investor but only upon the terms and conditions

16 set forth within the custodial agreement, is that correct?

17 A. Yes, that's the text of it.

18 Q. And so Mr. Rhoades' agency relationship with the county

19 or the school district under this agreement is limited to the

20 terms of this agreement, correct?

21 A. Yes. That's what it reads, correct.

22 Q. And the agreement has a section that's entitled Duties

23 of the Agent and Custodian, is that correct?

24 A. Correct.

25 Q. And that indicates that the custodian will execute

Smith - Cross

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1 purchases and redemptions pursuant to the investor's order

2 directly, or through the agent for the investor's account of

3 various investments, then lists a number of different

4 investments, is that correct?

5 A. Correct.

6 Q. And the agreement then states that the agent and the  
7 custodian will not render advice as to the value of, or make  
8 recommendations as to the advisability of purchasing or  
9 selling the investment?

10 A. Correct.

11 Q. And under the terms of the agreement, the -- any  
12 investment that is purchased on behalf of either Venango  
13 County or the school district is to be deposited with the  
14 custodian, that being Ameriserve, is that correct?

15 A. Where do you see that? I don't have the whole document  
16 on the screen.

17 Q. Under number one, under registrations it said that  
18 investment held for the investor's account by the custodian  
19 may be placed in the nominee name of U.S. National Bank Trust  
20 Department as custodian for Venango County GO bond issue,  
21 1989 project?

22 A. It says they may be placed in a nominee name at what is  
23 Ameriserve. Doesn't say that they have to be; at least the  
24 way I interpret that registration sentence.

25 Q. And under the statements section, it says that the

1 custodian will send a confirmation as purchases and sales are  
2 made for the investor and a monthly statement setting forth  
3 all transactions during the period and the value of each  
4 outstanding investment?

5 A. That's correct.

6 Q. And then the investor is to notify the custodian if the  
7 investor believes that there is any inaccuracy in the  
8 statements, is that correct?

9 A. Correct.

10 Q. And Ameriserve did send monthly statements to both  
11 Venango County and the school district?

12 A. That's correct.

13 Q. But, none of the statements to Venango County, at least  
14 in the time period of the indictment, none of the statements  
15 to either the school district or to Venango County ever  
16 indicated that there were -- that Ameriserve was holding any  
17 assets on behalf of either Venango County or the school  
18 district, correct?

19 A. I would agree with that, in most part, it showed that  
20 they had put money into the account. So for one day, they

21 held assets. Then the money left the account. Sometimes it

22 left the same day. If you are asking if it showed the CD's,

23 it did not show any CD's there.

24 Q. So, the statements that Ameriserve would send both the

25 school district and the county would show money coming into

Smith - Cross

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1 the county, school district funds, and then that money taken

2 out very quickly.

3 A. Correct.

4 Q. But, the statements never showed any CD's or any other

5 asset that was actually either purchased being held by

6 Ameriserve for the county or the school district?

7 A. That's correct.

8 Q. And in the Appointment of Agent and Custodian paragraph

9 at the top, it states that United States National Bank, or

10 its successors, as custodian, is appointed custodian for the

11 purpose of holding cash and investments of the investor

12 purchased by the custodian hereunder or otherwise transferred

13 to the custodian by the investor for safekeeping, correct?

14 A. That's what it reads, yes.

15 Q. So, the bank is the custodian, meaning the bank is the

16 one that is supposed to be having custody of any investments

17 that were actually purchased under the agreement?

18 A. The bank is the custodian for purposes of holding cash

19 investments, and if investments are --

20 THE COURT: Excuse me. Try to keep your voice up

21 until that calms down.

22 THE WITNESS: To go back and answer your question,

23 it says that they are the custodian for purposes of holding

24 cash and investments of the investor purchased by the

25 custodian or otherwise transferred.

Smith - Cross

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1 Maybe you can clarify the question. I am not sure

2 what the question is.

3 Q. The bank is appointed the custodian on behalf of Venango

4 County and in the agreement with the school district, for the

5 school district as well?

6 A. Correct.

7 Q. For the purposes of holding investments that are

8 purchased on behalf of either the school district or the

9 county?

10 A. Correct.

11 Q. Now, Mr. Rhoades did actually work for Irwin Union

12 Capital Corporation, correct?

13 A. That's what the records show, yes.

14 Q. Have you done any investigation to determine whether

15 that is accurate or inaccurate?

16 A. Yes. My investigation was to obtain those records, and

17 those show that he did work for Irwin Union.

18 Q. And Irwin Union Capital Corporation was a legitimate

19 corporation?

20 A. As far as I know, yes.

21 Q. And as far as you know, Mr. Rhoades had, in fact, at one

22 time been employed by the City of Erie, is that correct?

23 A. I believe my information was that it was the county.

24 Q. Or the county. In the Finance Department?

25 A. Correct.

Smith - Cross

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1 Q. Now, under the terms of the custodial agreement that

2 Mr. Rhoades had, is it accurate that the county and the

3 school district were to wire money into the accounts at

4 Ameriserve, that Mr. Rhoades was to be able to access that

5 money so that he could then take the money, purchase  
6 investments and then put those -- give those investments to  
7 Ameriserve to hold as the custodian?

8 A. That was the purpose of the custodial agreement. It  
9 doesn't actually specify that Mr. Rhoades -- you know, in  
10 that detail and I don't think it -- you know, that it's not  
11 an exclusive arrangement that Mr. Rhoades has to bring CD's  
12 back to Ameriserve.

13 Q. But, it was the understanding of both the school  
14 district and Northwestern that the CD's that they thought  
15 were being purchased were being held by Ameriserve?

16 A. Yeah, that is what they believed.  
17 Q. And you confirmed that with both school district and  
18 with Venango County?

19 A. Yes; and some of that indication comes from the  
20 statements as well. The statements tell them that as such.

21 Q. It's accurate to say that every statement that you are  
22 aware of that Mr. Rhoades sent to either the school district  
23 or Venango County would say on the statement that all assets  
24 were being held by Ameriserve?

25 A. That's correct.

Smith - Cross

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1 Q. And that appeared in all of the investment confirmations

2 Mr. Rhoades sent out, correct?

3 A. Yeah. Just so we are not confusing -- investment

4 confirmations sent by Mr. Rhoades, yes, it appeared in there.

5 If you are getting at the auditor confirmation,

6 that is something different.

7 Q. But, the confirmations that Mr. Rhoades sent out, those

8 investment confirmations, he would put on those statements

9 all assets are being held by Ameriserve?

10 A. Correct.

11 Q. And the monthly statements that Mr. Rhoades would send

12 out would say all assets are being held by Ameriserve?

13 A. Yes.

14 Q. And the maturity reports that Mr. Rhoades sent out said

15 that all assets were being held by Ameriserve?

16 A. Yes.

17 Q. And so it was clear to Venango County and to the school

18 district that, as far as they were concerned, the actual CD's

19 were being held by Ameriserve?

20 A. Yes, that was their impression and their belief.

21 Q. And, in fact, with your chronology of investments that  
22 laid out the different amounts that were invested by the  
23 Venango County and the school district, which is Government  
24 Exhibit 9, for each one of those transactions there is either  
25 an investment confirmation or a monthly statement sent out by

Smith - Cross 45

1 Mr. Rhoades with regard to each one of these transactions?

2 A. That is correct. Typically, there was a maturity  
3 report, which was the date that CD's matured, and then as  
4 they rolled them into the next set of CD's, there was an  
5 investment confirmation.

6 So, there were two documents when the CD's matured.

7 Q. And those different documents sent out by Mr. Rhoades,  
8 be they the maturity report or investment confirmations or  
9 monthly report, are represented in Government's Exhibits 6, 7  
10 and 8?

11 A. I don't have them in front of me. But, yes, they were  
12 represented in the documents presented to me this morning.

13 Q. For example, Government Exhibit 6, which is a monthly  
14 statement to the school district, is that correct?

15 A. Correct. And it does read that the assets are held by

16 the custodian.

17 Q. Now, when October of 2003 came and the county wanted

18 their principal back because they weren't going to roll it

19 over, that's when Mr. Rhoades stopped communicating with the

20 county and the county learned that something was wrong, is

21 that correct?

22 A. That's correct.

23 Q. And, in fact, then the former treasurer, Miss Spence,

24 then contacted Ameriserve directly, correct?

25 A. I don't know if the treasurer, Miss Spence, contacted

Smith - Cross

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1 Ameriserve directly or not. I know the current treasurer and

2 members of the county government had contacted Ameriserve.

3 I think you may be referring to Miss Sharp, the

4 current treasurer.

5 Q. And when the county contacted Ameriserve, they asked

6 Ameriserve about the status of the CD's Ameriserve had on

7 account for the county?

8 A. Correct.

9 Q. And Ameriserve informed the county that Ameriserve had

10 no CD's on account for the county?

11 A. Correct.

12 Q. And that they never had had any CD's on account for the

13 county?

14 A. For that time period, yes, the time period of the

15 indictment.

16 Q. The time period of the indictment?

17 A. Yes.

18 Q. Now, Mr. Piccinini asked you some questions about audits

19 and what they are designed to do and what they are not

20 designed to do.

21 I want to ask you some questions on that area.

22 A. Sure.

23 Q. An audit is not designed to detect fraud, correct?

24 A. A financial statement audit, which was what these two

25 auditing firms were engaged to do, is not designed to detect

Smith - Cross

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1 fraud, correct.

2 Q. But, a financial statement audit is designed to detect

3 material misstatements on financial statements, correct?

4 A. Correct.

5 Q. And included in these statements, in the financial

6 statements, would be listing assets that are owned by the

7 entity being audited, correct?

8 A. Correct.

9 Q. And so part of the auditing process, the financial

10 statement auditing process, would be confirming the existence

11 of the assets that are related on the entity's financial

12 statements, correct?

13 A. That's correct.

14 Q. And so part of the auditing procedures, for both the

15 audits done for the school district and for the county, was

16 the auditors confirming the existence of assets that were

17 listed by either the county or the school district on their

18 financial statements, correct?

19 A. That is part of their audit, correct.

20 Q. And, for example, the school district in its financial

21 statements, it listed the CD's that it thought it had

22 invested through Mr. Rhoades, they listed those CD's on their

23 financial statements, correct?

24 A. I believe that those would be included in an amount on

25 their financial statements. Whether they actually listed the

1 individual CD's, I am not aware of that.

2 Q. But, if they don't have the individual CD's listed, they  
3 will have listed that this amount of money is invested in  
4 CD's?

5 A. Yes, this would be a --

6 Q. And the school district would do the same thing?

7 A. Correct.

8 Q. And then during the audit process, the CPA firms doing  
9 the audits would try and confirm the existence of those CD's?

10 A. Correct.

11 Q. Because the auditing firms would need to make sure that  
12 the statement on the financial statements that the county had  
13 a million and a half dollars invested in CD's was accurate?

14 A. Correct.

15 Q. Because if the county had listed on their financial  
16 statements that they -- that one of their assets was a  
17 million and a half dollars invested in CD's and if that was  
18 not truly the case, that would be a material misstatement on  
19 the county's financial statements?

20 A. I haven't done their audit so I wouldn't be able to tell

21 you what the materiality levels are and whether that would be

22 material. But, I would presume, based on the size of the

23 county, that 1.5 million would be material.

24 Q. And the same for the school district. If the school

25 district's financial statement said we had either \$495,000

Smith - Cross

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1 invested in CD's, or later 198,000 invested in CD's, part of

2 the auditing process would be to confirm that those CD's

3 existed?

4 A. That's correct. And, again, with the school district, I

5 did not review their financial statements and whether I would

6 be -- I wouldn't be confident in saying -- I would be much

7 less confident in saying whether \$198,000 would be material

8 for them.

9 Q. Now, you and Mr. Piccinini talked about some exhibits

10 that were used by the various accounting firms in doing the

11 audits.

12 A. Correct.

13 Q. And one of the items that you guys talked about was

14 Government Exhibit 10, is that correct?

15 A. Correct.

16 Q. Now, that was a form sent by the school district's

17 accountants, that would be Root, Spitznas, to Mr. Rhoades,

18 correct?

19 A. Correct.

20 Q. The purpose of that being to try and confirm the

21 existence of the CD's that the school district thought it had

22 purchased?

23 A. The existence and the value.

24 Q. Now, that form is entitled Standard Form to Confirm

25 Account Balance Information with Financial Institutions, is

Smith - Cross 50

1 that correct?

2 A. Correct.

3 Q. Rhoades Capital Management was not a financial

4 institution, correct?

5 A. It's what you want to characterize it. I mean, is it

6 registered as a bank? No. I mean, I don't know if you want

7 to characterize it as a financial institutions or not. I --

8 Q. And to your knowledge, did Root, Spitznas send

9 confirmation notices to Ameriserve?

10 A. No, they did not; not that I know of, no.

11 Q. Government Exhibit 11 is a confirmation form used by

12 McMahon, O'Polka, Guelcher, and Associates, the CPA that the

13 county used, correct?

14 A. Correct.

15 Q. And basically a cover letter indicating what they are

16 trying to confirm, but then also attaching the investment

17 confirmations sent by Mr. Rhoades to the county. Those

18 statements were attached to the verification that McMahon,

19 O'Polka sent, correct?

20 A. Yes.

21 Q. And the statements from Mr. Rhoades, the -- for example,

22 one of them is a statement dated December 16th, 1999, and

23 it's referring to a \$100,000 CD that is purported to be

24 purchased from First Fidelity Investment & Loan in

25 California, is that correct?

Smith - Cross

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1 A. Correct.

2 Q. And that statement at the bottom, as all of Mr. Rhoades'

3 statements did, stated that all assets are held by the

4 custodian, here it says USBANCORP, but that's the predecessor

5 to Ameriserve, correct?

6 A. I believe it says that. But, if you can slide it up, I

7 can conform that. Yes.

8 Q. And that confirmation also included a statement from

9 Mr. Rhoades dated December 16th, 1999, wherein the investment

10 or the monthly statements from Mr. Rhoades purports to say

11 that there is a CD in the amount of \$100,000 purchased from

12 Life Bank in California, is that correct?

13 A. Correct.

14 Q. And, again, that statement from Mr. Rhoades on his

15 business letterhead states that all assets are held by the

16 custodian, is that correct?

17 A. Correct.

18 Q. And when they refer to all assets, that's referring to

19 the CD's themselves, correct?

20 A. Yes.

21 Q. And to your knowledge, McMahon, O'Polka never sent any

22 confirmation notices to Ameriserve, is that correct?

23 A. Correct.

24 Q. Now, while an audit is not designed to detect a fraud,

25 sometimes in the course of conducting an audit a fraud is

Smith - Cross

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1 discovered, is that correct?

2 A. That's possible, yes.

3 Q. Or even if you just -- something comes back where

4 someone is not confirming the existence of an asset, the

5 auditors will report that to the entity they are auditing,

6 correct?

7 A. Certainly.

8 Q. The auditors, it's not part of their job then to go out

9 and figure out what happened to that asset?

10 A. Correct.

11 Q. But, the auditors will bring that to the attention of

12 the people being audited?

13 A. Correct.

14 Q. And so through that process, frauds can be detected?

15 A. Correct. And if I can clarify, they will bring it to

16 the attention of the private person engaging them to conduct

17 the audit. In some cases, a third-party entity may have an

18 auditor audit someone. They may not report it to management

19 in the company.

20 Q. In this case, it would have been -- in this case, it was  
21 the management, so to speak, of the county and the management  
22 of the school district that had asked for the audit, correct?

23 A. Correct.

24 Q. And, therefore, the auditors would report any  
25 materiality misstatements to either the county or the school

Smith - Cross 53

1 district?

2 A. Correct.

3 Q. Mr. Rhoades never had the ability to prevent either the  
4 county or the school district from contacting Ameriserve, is  
5 that correct?

6 A. I think in some ways you could say that's not correct  
7 because by providing them with statements, confirmations  
8 confirming things with the auditors, he had -- he had the  
9 ability to persuade them or provide other evidence that would  
10 cause them not to confirm it with Ameriserve. If they wanted  
11 to, he didn't have the ability to physically stop them, but  
12 he had the ability to motivate them in ways to prevent them  
13 from doing that.

14 Q. Well, under your reading of the custodial agreement,

15 Mr. Rhoades was not required to deposit the contracts with

16 Ameriserve, correct?

17 A. It's just -- the custodial agreement allowed an

18 arrangement that allowed him to do such a thing. It didn't

19 require him. No, it wasn't exclusive.

20 Q. So, under the custodial agreement, Mr. Rhoades could

21 have said I am the one that has the CD's?

22 A. He could have said that, yes.

23 Q. And Mr. Rhoades did not do that, correct?

24 A. Correct.

25 Q. In every instance when Mr. Rhoades would send any type

Rollage - Direct

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1 of written confirmation to either the county or the school

2 district regarding the supposed CD's, every one of those he

3 would say the assets are being held by Ameriserve?

4 A. Correct.

5 MR. PATTON: Can I have a moment, Your Honor?

6 Those are my questions, Your Honor.

7 THE COURT: Any redirect?

8 MR. PICCININI: No, Your Honor.

9 THE COURT: Thank you, Mr. Smith.

10 (The witness was excused.)

11 MR. PATTON: I think our next witness is going to

12 take some time, so I don't know if you want to go ahead.

13 THE COURT: Let's take a break now and then we'll

14 reconvene at eleven o'clock.

15 (Court recessed at 10:45 a.m.)

16 (Court reconvened at 11:00 a.m.)

17 THE COURT: Be seated, please. Okay, Mr. Patton.

18 MR. PATTON: Your Honor, I would call Michael

19 Rollage.

20 THE COURT: Would you come forward and be sworn,

21 please?

22 THE CLERK: Can you raise your right hand?

23 \* \* \* \* \*

24 MICHAEL P. ROLLAGE, having first been duly sworn,

25 testified as follows:

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1 THE COURT: Have a seat up there, please, give us

2 your name and spell your last name.

3 THE WITNESS: Michael P. Rollage. R-o-l-l-a-g-e.

4 THE COURT: Thank you.

5 DIRECT EXAMINATION

6 BY MR. PATTON:

7 Q. Mr. Rollage, where do you work?

8 A. I am a partner in the firm of McCrory & McDowell in

9 Pittsburgh.

10 Q. What kind of firm are you guys?

11 A. We are a certified public accounting and consulting

12 firm.

13 Q. Can you give the Judge kind of a breakdown of your work

14 experience as a CPA?

15 A. Yes. I graduated from the University of Cincinnati in

16 1970. I had been -- spent three years prior to graduation as

17 a co-op student with a firm that is now known as

18 Ernst & Young. And then for the ensuing three years, I was

19 the -- I was on the Ernst & Young audit staff, rising from --

20 starting off as a staff accountant to senior accountant to a

21 supervisor.

22 In 1973, mid to late 1973, I left the firm of

23 Ernst & Young and went to work as the controller of a

24 mechanical contractor in Pittsburgh by the name of Pittsburgh

25 Mechanical Systems.

Rollage - Direct 56

1 I left there after about two and a half years and  
2 became the CFO of a company, of a heavy highway contractor by  
3 the name of Gal Construction located in Belle Vernon and left  
4 there in 1983.

5 In January of 1984, I joined the firm of McCrory &  
6 McDowell. I then became a partner there about six months  
7 later, and I am responsible for our construction services  
8 practice at McCrory & McDowell which consists of audits,  
9 reviews of financial statements and consulting in the  
10 construction industry.

11 In addition, I'm an adjunct professor at the  
12 University of Pittsburgh teaching a course in construction  
13 finance and cost control.

14 Q. Do you have any professional licenses or certifications?  
15 A. Yes. I'm a certified public accountant in the State of  
16 Pennsylvania. I'm accredited by the American Institute of  
17 CPA's and an accredited business valuator and I'm a certified  
18 valuation analyst.

19 Q. Do you belong to any professional or trade

20 organizations?

21 A. Yes. American Institute of Certified Public

22 Accountants, the Pennsylvania Institute of Certified Public

23 Accountants, the Construction Financial Manager's

24 Organization and several trade associations affiliated with

25 the construction industry.

Rollage - Direct 57

1 Q. Do you do any type of volunteer work?

2 A. Yes. I'm the treasurer of my church. I do volunteer

3 work for the Pittsburgh Food Bank. I have been quite

4 involved in the Boy Scouts of America and have done some work

5 for a group called Youth Opportunities Unlimited in

6 Pittsburgh.

7 Q. In your employment as a certified public accountant,

8 have you performed audits?

9 A. Yes, I have.

10 Q. How long have you been doing that?

11 A. Well, again, I have been with McCrory & McDowell for a

12 little over twenty years, and that's really all I do. I'm on

13 the audit staff and the bulk of my work is audits.

14 MR. PATTON: Your Honor, I would offer Mr. Rollage

15 as an expert in certified public accounting and audits.

16 THE COURT: Any voir dire, Mr. Piccinini?

17 MR. PICCININI: No, Your Honor.

18 THE COURT: He may testify as an expert in the

19 field of accounting.

20 BY MR. PATTON:

21 Q. Mr. Rollage, can you just explain, in general terms,

22 what an audit is?

23 A. A CPA firm has three levels of assurance that they can

24 issue with financial statements. The highest level of

25 assurance is an audit and that's followed by a review, and

Rollage - Direct 58

1 then the least level of assurance is a compilation.

2 Q. What is an audit designed to do?

3 A. An audit is designed to give the reader of the financial

4 statement, that the financial statements are prepared in

5 accordance with generally accepted accounting principles and

6 that they follow generally accepted auditing standards in the

7 preparation of that -- and the execution of their work in

8 preparing that financial statement.

9 Q. Is the audit, itself, designed to detect fraud within

10 the entity or company being audited?

11 A. No, it is not.

12 Q. During the course of conducting an audit, can a fraud be

13 discovered?

14 A. It can be.

15 Q. And if that happens, what does the auditor do?

16 A. They would report to the people who have engaged them

17 that they found something. They may withdraw from the

18 engagement or they may proceed and help to quantify the fraud

19 and proceed on in the engagement.

20 Q. When you are engaged to conduct an audit of an entity's

21 financial statements, what is the first step of what the

22 auditors have to do?

23 A. The first step is that they have to gain an

24 understanding of what we refer to as the control environment.

25 And that is, the control environment is the environment that

1 exists for the safeguarding of assets and the transactions

2 that take place that they, in fact, are what they say they

3 are.

4 So, the auditor, the first thing they would do

5 would be to gain an understanding of that control

6 environment.

7 Q. Is it incumbent upon the auditor to, when you say become

8 familiar with the control environment, to sit down with the

9 management of the entity being audited to learn the facts

10 behind what's listed on the financial statements and how

11 financial transactions are conducted and how assets are held,

12 and things of that nature?

13 A. Yes, it is.

14 Q. And once an auditor becomes sufficiently familiar with

15 the control environment in the entity that's being audited,

16 what do you then do?

17 A. You would develop an audit program that would be

18 designed to test the control environment as it's been

19 represented to you and to be able to form conclusions with

20 respect to the existence of assets.

21 Q. And after those procedures have been developed and have

22 been followed through, ultimately what is it that the

23 auditors want to be able to go back and tell the management

24 of the entity that's being audited?

25 A. Ultimately, they want to be able to issue their opinion

Rollage - Direct 60

1 on the financial statements.

2 THE WITNESS: Is that me bouncing that or --

3 THE COURT: No, that is all right.

4 THE WITNESS: Okay. They are -- their ultimate

5 goal is to be able to issue a financial statement and then to

6 issue an opinion on the financial statement stating what they

7 did, that the statements are prepared in accordance with

8 generally accepted accounting principles and that their audit

9 was conducted in accordance with generally accepted auditing

10 standards.

11 Q. Could you just briefly explain what generally accepted

12 auditing standards are?

13 A. Generally accepted auditing standards are standards that

14 are promulgated by the American Institute of Certified Public

15 Accountants, and there are general standards, standards of

16 field work, standards of -- that the auditor has to go

17 through in order -- in developing the test that he is

18 conducting.

19 Management is, in essence, making assertions as to  
20 the classifications and existence of account balances, be  
21 they assets, liabilities, income, expenses. And what the  
22 auditor is designed -- the audit is designed to determine  
23 whether there could be a material misstatement or a -- on one  
24 of those assertions, that when you take all of them in total,  
25 they are going to cause a misstatement on the financial

Rollage - Direct 61

1 statement itself.  
2 Q. Is part of doing the audit and checking on the  
3 assertions made in the financial statements attempting to  
4 verify the existence of assets that are listed by the entity  
5 being audited on their financial statements?  
6 A. That would be one of many procedures that would be  
7 undertaken in order to satisfy yourself that those assertions  
8 are, in fact, correct.  
9 Q. I want to ask you some questions now designed more -- or  
10 with regard more to the facts of this particular case.  
11 A. Okay.  
12 Q. Have you had a chance to review the audits that were

13 performed on behalf of the Northwestern School District and

14 Venango County?

15 A. I analyzed the financial statements, yes.

16 Q. And have you had a chance to review the indictment in

17 this case?

18 A. I have read them, yes.

19 Q. And have you had a chance to review the search warrants

20 done by the FBI agents describing in general their

21 investigation of Mr. Rhoades?

22 A. Yes.

23 Q. And I want to ask you some questions about the CD's or

24 the CD's that were supposed to have existed in this case.

25 A. Okay.

Rollage - Direct 62

1 Q. And for right now, I'll ask about the county.

2 And if you were doing an audit of the county's

3 financial statements and the county's financial statement

4 listed as an asset a million and a half dollars in CD's, as

5 part of your audit, would you need to try and verify that

6 information?

7 A. Yes.

8 Q. What steps would you take to verify that information?

9 A. Well, the first step I would take is to determine what

10 the control environment was that existed around those audits.

11 That would consist of determining, number one, who had the

12 authority to make the investments. Under what rules,

13 regulations, whether it was Pennsylvania Code, or in this

14 particular case, or whatever, they were allowed to make the

15 investments, who had the authority to make the investment.

16 And then I would want to determine the existence of the

17 asserted balance that was reported on the balance sheet.

18 Q. How would you try to confirm the existence of the CD's

19 in this case?

20 A. I would send a confirmation.

21 Q. And who would you send the confirmation to?

22 A. To the custodian of the funds.

23 Q. And through your attempts to gain an understanding of

24 the control environment, would you have talked with the

25 county officials to determine where physically the CD's were

2 A. Yes.

3 Q. Once you learned from the county officials, either

4 through written documentation or through their oral

5 representations to you, where would you go to verify the

6 existence of --

7 A. I would -- I could do one of two things. If the assets

8 were held in a safe deposit box in a bank that was local, I

9 could go and count them or -- physically count them. Or I

10 could design a bank confirmation or a confirmation to send to

11 that institution verifying or asking them to verify that

12 those assets were being held in safekeeping.

13 Q. In your meeting with the county officials and -- or your

14 review of the documentation that the county officials gave to

15 you indicated that the county officials believed that the

16 million and a half dollars in CD's that they thought they had

17 invested were being physically held in Ameriserve Bank in

18 Johnstown, Pennsylvania, but had been purchased on behalf of

19 the county by Gary Rhoades but then deposited at Ameriserve,

20 where would you go to confirm the existence of those CD's?

21 A. Ameriserve.

22 Q. And why would you go to Ameriserve?

23 A. Gary Rhoades would have been the agent. That would be

24 like asking the fox to tell me how many hens were in the hen

25 house.

Rollage - Direct 64

1 Q. And would -- under -- if you were using generally

2 accepted auditing standards, would you have sent a

3 confirmation to Gary Rhoades?

4 A. I would not.

5 Q. And if your engagement letter with the county stated

6 that you were going to use generally -- or the audit would be

7 done pursuant to generally accepted auditing standards, would

8 you send the confirmations to Gary Rhoades?

9 A. No. I might add, an auditor is responsible for after

10 they gain an understanding of the control environment and if

11 they determine that confirmations are to be sent, if they

12 decide that that is the appropriate test, then they are to

13 send it to the party that they determine is most likely to

14 give them -- to verify that these assets existed.

15 In the particular case, Mr. Rhoades is the agent

16 and I would not send it to the agent, but rather to the

17 custodian because they are the people that were holding the

18 funds supposedly.

19 Q. And so, for example, if you look on your screen showing

20 Government Exhibit 11, which was a confirmation request sent

21 out by McMahon, O'Polka, Guelcher and Associates, which was a

22 CPA firm engaged by the county, attached to that confirmation

23 is -- are some monthly statements sent by Mr. Rhoades to the

24 county regarding in -- for example, in this case a \$100,000

25 CD, and that statement, itself, at the bottom says that all

Rollage - Direct 65

1 assets are held by the custodian, in this case, USBANCORP

2 Trust Company Johnstown, Pa.

3 If you had been shown that monthly statement from

4 Mr. Rhoades that had that information on it, where would that

5 tell you as an auditor you needed to go to confirm the

6 existence of that CD?

7 A. To USBANCORP.

8 Q. Should you go to Mr. Rhoades to verify the existence of

9 that asset?

10 A. In my professional opinion, no.

11 Q. If the auditors sent the confirmation notice to

12 Mr. Rhoades and did not send a confirmation to USBANCORP,

13 would that be in accordance with generally accepted auditing

14 standards?

15 A. Again, I don't think that it was -- they -- I have not

16 had the opportunity to talk to the CPA's or to look at their

17 assessment of the control environment, but based on the

18 information that I have seen, the control environment was

19 that there was an agent and that agent invested the

20 securities with a particular bank, and I believe that the

21 most appropriate method of confirming the existence of those

22 assets would have been to send the confirmation to the

23 institution that was holding them.

24 Q. And you heard the testimony from Agent Smith earlier

25 that the officials in Venango County believed, wrongly, but

Rollage - Direct 66

1 the county officials believed that the CD's were being held

2 by Ameriserve Bank.

3 A. Yes, I recall that.

4 Q. And so if the county officials, if they had passed that

5 information on to you as an auditor that it is our

6 understanding that these investments are being held by

7 Ameriserve Bank, would you have sent a verification to

8 Ameriserve?

9 A. Absolutely.

10 Q. For the reasons that you discussed?

11 A. That's correct.

12 Q. Now, if your engagement letter with the county said that

13 you would conduct the audit using generally accepted auditing

14 standards, but the letter also said that, look, the purpose

15 of the audit is not to detect fraud, that the audit is not a

16 guarantee of the accuracy of the financial statements and is

17 subject to the inherent risk that errors, irregularities or

18 illegal acts might not be uncovered through the audit, would

19 that change, in any way, your determination of where you

20 would send the confirmation?

21 A. I don't believe so. You used the term "inherent risk."

22 When you're preparing financial statements, the

23 first thing, as I said, you do is, you evaluate the system of

24 internal control and you are evaluating risk in the system of

25 internal control. Two types of risk; one is control risk and

1 two is inherent risk. Inherent risk is that risk that a

2 possible misstatement could, in fact, take place if there

3 were no other controls in effect.

4 So, when the CPA would have gained an understanding

5 of the control environment, they should -- they should have

6 been told that the -- there was an agent involved, that the

7 securities were, in fact, held by USBANCORP. And, in fact,

8 the internal documentation appears to have indicated that.

9 And so, therefore, the professional judgment that I

10 believe should have, or conclusion that should have been

11 reached was that the appropriate place to confirm the

12 existence of that asset was USBANCORP.

13 Q. When you talk about inherent risk, in the way the CD's

14 were purchased, or purported to be purchased in this case,

15 where the money was taken by an agent and then was supposed

16 to be used to buy CD's, then deposit the CD's with a bank, is

17 there inherent risk in that setup?

18 A. Yes. There -- well, there is the -- the inherent risk

19 is, A, did the person who gave the authority to buy the

20 securities have that authority? That is one.

21 So, in gaining your understanding of the control

22 environment, you would determine who has that authority and

23 from there you would test that.

24 Two. You would look at the agency relationship and

25 ask in -- my professional opinion, you would ask if there

Rollage - Direct 68

1 is -- is there any type of an agreement that you have with

2 the agent that you are -- that is purchasing from you -- with

3 you?

4 And then you would look at that and determine

5 what's supposed to happen there. And based upon the

6 inquiries that you make and the documentation that you

7 receive, you'll design your audit test accordingly.

8 And from what I have heard today and what I have

9 read, I believe that leads you to the conclusion that the

10 appropriate place in order to have reasonable assurance that

11 the assertion that was made may be incorrect would have been

12 to send that bank confirmation to USBANCORP.

13 Q. Okay. And prior to today, did you have an opportunity

14 to review what has been marked here as Government Exhibit 2,

15 which is the custodial agreement between Venango County and

16 Ameriserve?

17 A. Yes.

18 Q. And you also have had an opportunity to review the  
19 custodial agreement between Mr. Rhoades or Rhoades Capital  
20 Management and Ameriserve?

21 A. Yes.

22 Q. And I believe your testimony just was that once you  
23 found out about the circumstances under which -- or the  
24 procedures that were used to purchase the CD's, you would  
25 have asked about any agreement that existed to authorize the

Rollage - Direct 69

1 agents to make the purchases, is that correct?

2 A. I would want to know who had the authority to make that,  
3 to make the purchases; number one. And, number two, was  
4 there any type of an agreement that existed between the agent  
5 and the county.

6 Q. And if you had been shown Government Exhibit 2, which is  
7 the custodial agreement between the county and Ameriserve,  
8 would that have caused you any reason to want to send your  
9 confirmation to Mr. Rhoades rather than to Ameriserve?

10 A. No.

11 Q. Mr. Rollage, in your opinion, if the auditing firms at

12 issue in this case, the auditing firm for the county and for

13 the school district, had followed generally accepted auditing

14 standards, do you believe they would have sent confirmations

15 to Ameriserve Bank?

16 A. I believe they would have.

17 Q. And if Ameriserve Bank would have sent back a letter

18 saying we do not have any assets, we don't have any CD's or

19 any other type of assets on behalf of either the county or

20 the school district, as an auditor would you then report that

21 to either the school district or the county?

22 A. I would.

23 MR. PATTON: Those, my questions, Your Honor.

24 THE COURT: Mr. Piccinini.

25 MR. PICCININI: Thank you, Your Honor.

Rollage - Cross 70

1 CROSS-EXAMINATION

2 BY MR. PICCININI:

3 Q. Mr. Rollage, how do you know that there is not a fox in

4 Ameriserve when you are conducting an audit?

5 A. You don't. You design your audit tests around your

6 understanding of the control environment.

7 Q. And you would agree with me that you don't necessarily

8 know if there is a dishonest person on the other end of those

9 confirmation documents, do you?

10 A. Well, the first thing you would do would be to make sure

11 you are sending the confirmation to the right person.

12 Q. But, he is the right person according to the information

13 that has been provided to you by your client.

14 A. Not if my client has told me that that person is the

15 agent. And if, in fact, on the face of the document that

16 they give me tells me that the securities are being held by a

17 financial institution, that confirmation is sent to the wrong

18 person.

19 Q. But, you say that the first thing that one should do in

20 conducting an audit is to gain an understanding of the

21 control environment, is that correct?

22 A. Correct.

23 Q. And you would agree with me that to gain an

24 understanding of the control environment, you wouldn't just

25 pull together documents that existed and read them on your

1 own, would you?

2 A. That would be one of several things that I would do.

3 Q. But, in this particular case, your opinion is based upon

4 the documents that have been provided to you, is that

5 correct?

6 A. That is correct.

7 Q. And as you indicated, you never had the opportunity to

8 assess the control environment in Northwestern School

9 District or Venango County, did you?

10 A. I did not.

11 Q. You never had the opportunity to sit down with the

12 county treasurer or with other officials within the county

13 solicitor's office or with the county commissioners to talk

14 with them about their accounting and their control

15 environment there at the county?

16 A. I did not.

17 Q. Likewise, you never went to the finance director of the

18 Northwestern School District and you never sat down with him

19 and discussed with him the documentation that they had and

20 their understanding of their relationship with Mr. Rhoades,

21 did you?

22 A. I did not.

23 Q. But, you would agree with, me, however that in  
24 conducting an audit, in order to assess an understanding of  
25 the control environment, an auditor, which you weren't hired

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1 to do that here in this case, but an auditor would sit down  
2 with those folks and talk with them?  
3 A. Yes.  
4 Q. But, in your opinion here today, you lack an  
5 understanding from conversations with the people who were the  
6 victims in this case, you lack an understanding of their  
7 relationship with Mr. Rhoades since 1997, isn't that true?

8 A. That is true. However, I think that in my reading of  
9 the financial statements that were issued, they say that they  
10 were issued in accordance with generally accepted auditing  
11 and government standards. And that so I, as an auditor, that  
12 means something to me in terms of what they did.

13 I didn't do that, but it means something to me as  
14 to what they did.

15 Q. The documents mean something to you as to what they did?  
16 A. Yes.

17 Q. Isn't it also important to you as an auditor -- let's

18 say you were hired to conduct an audit.

19       Wouldn't you sit down with the folks and talk with

20 them about who it is that they trusted their money with to

21 invest?

22 A. That would be part of what I would do. But, I would

23 hope it would only be the surface of what I would do.

24 Q. In the course of your going through your background, you

25 talked about the fact that primarily you conduct audits in

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1 the construction services field in the construction industry?

2 A. Construction industry.

3 Q. And you talked today about generally accepted auditing

4 procedures.

5       Have you ever conducted an audit of a government

6 agency or a school district, for that matter?

7 A. Not a school district. But, my firm does a great deal

8 of work in the government industry. And I have -- I am not

9 the primary partner on it, but some of our continuing

10 education and firm meetings address those subjects.

11 Q. In addition to generally accepted auditing procedures,

12 there are also government auditing standards, as well?

13 A. That is correct.

14 Q. And in some respects, the government auditing standards

15 differ from generally accepted auditing standards because

16 they are more specific as to government entities?

17 A. That is correct.

18 Q. In this case, counsel asked you whether you reviewed the

19 audit and you responded that you reviewed the financial

20 statement, you never reviewed --

21 A. I'm sorry?

22 Q. I am sorry. I asked whether you did. You said you

23 analyzed the financial statements?

24 A. That is correct.

25 Q. Now, Mr. Rollage, what if the bottom of the confirmation

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1 documents that the county and Northwestern School District

2 received from Mr. Rhoades didn't say anything about the

3 Ameriserve, that when you assessed the control environment of

4 these entities they said our guy is Gary Rhoades, I am the

5 treasurer, and the previous treasurer and the treasurers that

6 I am aware of, have always used Gary Rhoades as our

7 investment guy. He is the guy we trust.

8 Same thing with the school district. We invest

9 with Gary Rhoades and I sent confirmation documents, and at

10 the bottom of it, it says nothing about Ameriserve.

11 Is your testimony that you would not send

12 confirmation documents to the county and the school

13 district's guy who invested their funds?

14 A. I need to know -- I would ask by inquiry, and by inquiry

15 would ask, who holds the funds? Where are they being held?

16 If I was told by the county and the school district

17 that they were being held by Mr. Rhoades, then I would

18 confirm with Mr. Rhoades.

19 Q. But --

20 A. I would also -- let me continue, please.

21 Q. I am sorry. Go ahead.

22 A. I would also ask them if any documentation existed as to

23 their arrangement with Mr. Rhoades. And if they reported

24 that there was none, then I would have to rely on their

25 verbal representations.

1        If, in fact, there was -- they confirmed that there

2    was and they gave it to me, I would review that.

3    Q. And what you just said, that you would have to rely on

4    their verbal representation in the auditing field, these are

5    not detailed audits of each and every account that exists

6    with the audited entity, are they?

7    A. They are not. But, the control environment is not to be

8    taken lightly in an audit. It is the absolute foundation

9    under which the auditing procedures are designed and it is

10   not -- and if it is not approached with care and if it's not

11   approached with the professional skepticism that an auditor

12   has to have, then the audit is built on a shakey foundation.

13   Q. But, you didn't do that in this case? You didn't -- in

14   order to render your opinion here today, you didn't assess

15   the control conditions in this case?

16   A. I was not engaged to do that.

17   Q. And you weren't?

18   A. Correct.

19   Q. I am not saying that you should have and you didn't.

20   You didn't because that wasn't your job here for today, is

21   that correct?

22 A. That is correct.

23 Q. And you had the opportunity to talk to the accountants

24 who actually would have been required to assess the control

25 environment. You didn't talk with them?

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1 A. I haven't talked with them, but I have seen, as the

2 government exhibit, as well as the documentation that was

3 provided to me, the auditor's confirmations. And based on

4 what I saw there, that indicated -- my professional

5 skepticism was raised to say -- to conclude that I would have

6 done something differently.

7 Q. But, you never had the benefit to actually sit down and

8 conduct the control assessment yourself?

9 A. I did not.

10 Q. In addition, you made the comment that sending a

11 confirmation to Mr. Rhoades would be like sending a fox in to

12 count the hens in the hen house.

13 But, don't you agree with me that audits, just like

14 when you go to your accountant, the strength of what they do

15 is, doesn't go in assuming that everybody is a liar, do they?

16 A. No. But, I believe that every auditor -- and I have

17 used this term several times today -- every auditor is told  
18 that they must approach the audit with professional  
19 skepticism, and by that, I've got the procedures that I have  
20 designed, and I have got -- I've got to design those  
21 procedures to gain reasonable assurance that I'm going to  
22 detect a misstatement of an assertion if it exists. That is  
23 a fact.

24 Q. You, as an individual conducting an audit, it's  
25 certainly not your testimony that you are not susceptible to

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1 being duped by a professional who is engaged in lying for  
2 several years? You are not above that, are you?  
3 A. I am not testifying to that, no.  
4 Q. And with regard to your fox in the hen house example,  
5 what if the fox is sufficiently disguised and you can't tell  
6 what -- if he is a person who appears to be a trusted  
7 financial advisor, he doesn't appear to the victims and he  
8 doesn't appear to the auditor to be a fox, to be a liar, what  
9 if he doesn't appear that way and he successfully dupes them  
10 and you send your confirmation documents to him and you are

11 successfully duped as well? That can happen, can it not?

12 A. If I would have sent it to the right person, I wouldn't

13 have been able to prevent the fraud, but I would have been

14 able to detect it.

15 Q. And your assessment of who the right person is is by

16 conducting this assessment of the control procedures in

17 determining who is the person that's in the position that I

18 should be able to go to to verify these investments?

19 A. Absolutely not. It's the person who is holding the

20 investment. Who is holding the investment is the fundamental

21 question. Where is it being held?

22 And in the auditing field, if it's inventory at the

23 end of the year, I go out and I count it. If it's money on

24 deposit at a bank, I send a bank confirmation to the bank.

25 If it's hard assets that exist in the parking lot, I may go

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1 out and kick the tires.

2 Again, my responsibility is to verify the existence

3 of the material assets if I determine that it's material.

4 Q. And in this case, for some reason which isn't known to

5 you because you weren't part of the auditing team, for some

6 reason, the location, the place where these confirmation  
7 documents went is to this man seated in the courtroom? For  
8 some reason, that happened?

9 A. That's correct.

10 Q. Have you been engaged by the law firm of Kirkpatrick &  
11 Lockhart to act as an accountant for them?

12 A. No, I don't believe so.

13 Q. Have you ever had a relationship with the law firm,  
14 Kirkpatrick & Lockhart, in Pittsburgh?

15 A. No. They have been a defendant in cases where I have  
16 been an expert, but I have not had a relationship with them.

17 Q. I am not asking whether you audited for them.

18 I am asking you whether or not you have ever been  
19 hired, employed or consulted with them in any fashion on any  
20 case?

21 A. No. Again, other than a case where they have been a  
22 party in a case where I have been an expert witness.

23 MR. PICCININI: Okay. Thank you. That is all I  
24 have, Judge.

25 REDIRECT EXAMINATION

1 BY MR. PATTON:

2 Q. Mr. Rollage, you heard the testimony from Mr. Smith  
3 today that the officials at the county and that the officials  
4 at the school district believed the CD's they had purchased  
5 through Mr. Rhoades were on deposit in Ameriserve, is that  
6 correct?

7 A. That's correct.

8 Q. If you were doing an audit for either the school  
9 district or the county and they told you just that, that we  
10 have used Gary Rhoades to buy these CD's, we think Gary is a  
11 great guy, we have used him for a long time, he bought the  
12 CD's for us and he has them, he then placed them at  
13 Ameriserve Bank and that's where they physically are being  
14 held, who do you send the confirmation to?

15 A. Unquestionably, Ameriserve Bank.

16 Q. Is part of your audit, as you have said when you are  
17 dealing with a financial statement audit, to determine  
18 whether or not the statements that are on the financial  
19 statement are somehow wrong?

20 A. Well, my test -- the statements are not my statements.  
21 They are the client's statements. So, in this case, either

22 the county or the school district made assertions to me that  
23 these are the assets, the liabilities, the income, the  
24 expense that they have and they have accounted for them in a  
25 certain way.

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1 And as I testified previously, after my -- after  
2 gaining an understanding of the control environment, we will  
3 tailor our audit program in a way that will give us  
4 reasonable assurance that those -- that there are not any  
5 material misstatements in those assertions that, when  
6 aggregated together, are going to lead to a material  
7 misstatement on the financial statement.

8 Q. Now, is it accurate to say that the auditor does have to  
9 rely, to some extent, in learning the control environment  
10 from information provided by the management of the people  
11 being invested?

12 A. Absolutely.

13 Q. But, does an auditor allow the management of the entity  
14 being audited to tell the auditor where the auditor has to go  
15 to do their confirmations?

16 A. Absolutely not.

17 Q. Who is responsible for making the determination of where

18 the proper verification has to come from?

19 A. The auditor.

20 Q. Is that part of the inherent -- inherently what comes

21 with being hired by an entity to audit their financial

22 statements?

23 A. Well, once again, one of the main objectives is to

24 determine the existence of the asset; in the particular case,

25 the CD.

1 So, the auditor is going to send his confirmation

2 to the person or institution that then is holding those CD's.

3 Q. So, if the -- for example, if Venango County had said,

4 look, the CD's are on file with Ameriserve but we purchased

5 them through Gary Rhoades so you should go to Gary Rhoades

6 and get your confirmation from Gary Rhoades, would you then

7 say, okay, fine, I will then go and confirm that with Gary

8 Rhoades?

9 A. No.

10 THE COURT: This is getting repetitious,

11 Mr. Patton.

12 Q. Is part of not getting duped as an auditor going to the

13 right place to confirm the existence of assets?

14 A. Part of not getting duped as an auditor is, again, to

15 understand the environment that you are working in. And if

16 you have a solid understanding of that environment, you

17 should have reasonable assurance that you are not going to

18 get duped.

19 MR. PATTON: Those are my questions.

20 MR. PICCININI: Nothing in response, Your Honor.

21 THE COURT: Thank you, sir.

22 THE WITNESS: Thank you.

23 (The witness was excused.)

24 THE COURT: Anything further, Mr. Patton?

25 MR. PATTON: We have no further evidence, Your

1 Honor.

2 THE COURT: Do you want to give me your argument?

3 MR. PATTON: Yes, please. And, Your Honor, can

4 Mr. Rhoades be excused?

5 THE COURT: Sure; not Mr. Rhoades. Mr. Rollage.

6 MR. PATTON: I'm sorry if I mispoke.

7 (The witness was excused.)

8 MR. PATTON: To clarify one thing on this argument.

9 In the government's response to our argument on the abuse of

10 position of trust issue, they say that Mr. Rhoades is trying

11 to avoid responsibility for the crime and blame the victims

12 for the crime and that's not accurate.

13 No one here disputes that the crimes have been

14 committed. Mr. Rhoades has pled guilty to those crimes and

15 the question, when it comes to abuse of position of trust, is

16 not, did Mr. Rhoades commit the crimes? He, of course, did.

17 The question is: Did he abuse a position of trust?

18 Which is a legal conclusion that you have to make based on

19 the facts in the case. And so it isn't an attempt to try and

20 avoid any kind of responsibility for the actions. It's

21 simply a legal question of, do these facts meet the legal

22 requirement of abuse of position of trust?

23 And the Third Circuit, as was set out in United

24 States versus Pardo, 25 F.3d 1187, the Third Circuit

25 established a three-part test for deciding whether someone

1 abuses a position of trust, and we have set it out. And,

2 Your Honor, I am sure, is familiar with it.

3 And where we would focus our argument on is mainly

4 that the first part of that test is whether Mr. Rhoades'

5 position allowed him to commit a difficult-to-detect wrong.

6 And I believe the Pardo case is very instructive to how the

7 abuse of position of trust enhancement applies in this case.

8 In Pardo, the defendant went to a bank to try and

9 open a bogus checking account so he could then do a check

10 kiting scheme. Well, the defendant had done just that to the

11 same bank on a prior occasion. The bank had not chosen to

12 file criminal charges, but they had entered Mr. Pardo's name

13 into their security system so that if he again tried to open

14 an account there, he would not be allowed to open an account.

15 So, the bank had in place a system of checks that,

16 had those checks worked properly, would have prevented

17 Mr. Pardo from opening an account and would have easily

18 detected his crime.

19 Those procedures weren't used because the manager

20 of the branch that Mr. Pardo went to was a friend of

21 Mr. Pardo's wife and so she didn't follow through the

22 procedures the bank had established. And because those

23 procedures weren't used, the offense was able to be

24 committed. But, the Third Circuit said that Mr. Pardo's

25 position as a friend of the bank manager did not give him the

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1 ability to commit a difficult-to-detect wrong. There would

2 have been nothing difficult to protect had the routine

3 precautions been taken. And, at most, Pardo's position as a

4 friend allowed him the opportunity to commit an

5 easily-detectable wrong.

6 Well, in this case, the county and the school

7 district set up procedures that they believed were a check

8 against Mr. Rhoades and that protected them from this very

9 crime.

10 Now, those procedures weren't followed, weren't

11 followed correctly, so the offense was able to occur. But,

12 it doesn't change the fact that had the precautions been

13 performed properly, if the procedures had been performed

14 properly, this would have been a very easily detectible

15 offense.

16        And oddly enough, Your Honor, you don't have to  
17  take my word for that, at least with regard to the county,  
18  because the county has said just that in the civil complaint  
19  it has filed against both Ameriserve Bank and against their  
20  auditors McMahon, O'Polka, Guelcher and Associates.

21        In the county's civil complaint itself, it states  
22  that -- this is paragraph 91 on page seventeen. It says:  
23        As the custodian of the county's public funds,  
24  Ameriserve had a fiduciary duty to the county to maintain and  
25  protect the funds in the custodial account and not to permit

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1  third parties to access county's funds without county  
2  authorization. The county trusted Ameriserve to safeguard  
3  its money and the county placed its confidence in Ameriserve  
4  to do so.

5        Now, that wasn't done. Now, you can argue as to  
6  whether or not Ameriserve's actions violated the law or not,  
7  but there can be no doubt that the county took the position  
8  of, we have, by using the custodial agreement and having the  
9  bank be the custodian where the CD's were actually going to

10 be filed, that gives us a level of protection because the

11 CD's are not going to be held by Mr. Rhoades, they are going

12 to be held by a bank in the bank's trust department.

13 They also then in their complaint in the breach of

14 fiduciary count against McMahon, O'Polka claim that, you

15 know, that they relied on McMahon, O'Polka to conduct a

16 proper audit and that the firm had a duty to detect any

17 material irregularities in the county's financial records and

18 the county trusted McMahon, O'Polka to perform the proper

19 audit and the county placed its confidence in the firm to do

20 so.

21 The point of the abuse of position of trust

22 enhancement is to prevent an insider from abusing that

23 position to commit this crime. And what the application

24 notes talk about is that an insider is someone that the

25 victim trusts so much that they really don't check up on the

1 insider, they don't take precautions to prevent themselves

2 from being defrauded because they view the defendant as an

3 insider and someone they don't have to check up on. The

4 county set up checks against Mr. Rhoades.

5 Now, even though those procedures failed doesn't  
6 change the fact that the county did not say Mr. Rhoades is a  
7 great guy, we trust him, we are not going to have his work  
8 reviewed at all. They didn't do that.

9 Had the audits been done in accordance with  
10 generally accepted auditing standards, verifications would  
11 have been sent to Ameriserve and they would have said we  
12 don't have any CD's. This would have been detected very  
13 easily.

14 The government has said, well, with regard to  
15 Mr. Rollage, well, you didn't talk to people from the county  
16 or school district, you don't know what they told the  
17 auditors. But, we know that Mr. Smith said he talked with  
18 the county and the school district people and their belief  
19 was the items were on the deposit in Ameriserve Bank. And  
20 every statement that Mr. Rhoades sent to the county and to  
21 the school district said that the assets were being held by  
22 Ameriserve Bank.

23 Now, it is not improper for Your Honor to then  
24 reach the conclusion that, of course, the auditors were told  
25 that the assets were being held in account at Ameriserve

1 Bank. And, in fact, we know that the county's auditors knew  
2 that because they received the statements from Mr. Rhoades  
3 and they attached them to the confirmation notice they sent  
4 out, and those statements from Mr. Rhoades specifically  
5 stated the assets were on account at Ameriserve.

6 Now, in the government's response, they also cited  
7 to United States versus Iannone, I-a-n-n-o-n-e, which is  
8 184 F.3d 214.

9 Now, at one point in that opinion, the majority  
10 opinion does say that, that in determining whether there was  
11 a difficult-to-detect wrong, the focus is not on the victim.  
12 The focus is exclusively on the defendant.

13 But, I would submit to you that that is dicta and,  
14 in fact, is contrary to what the majority opinion itself did.  
15 In affirming the abuse of position of trust, the majority  
16 looked at the scheme the defendant in that case had come up  
17 with and looked at the fact that because that person was the  
18 defendant was the only source of information regarding the  
19 investments that the defendants -- the defendants -- the  
20 victims couldn't go anywhere else to get any kind of

21 confirmation. They were totally dependent on the defendant.

22 Well, in that case, that's not the case here. And

23 also, as Judge Becker points out in his concurrences, that

24 it's simply you cannot say, when doing abuse of position of

25 trust analysis, that you don't look at the conduct of the

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1 victim.

2 And as Judge Becker points out, if that were the

3 case, Pardo could not have been decided the way it was

4 because the way they looked at Pardo was looking at the

5 victims, the bank and saying, look, the bank had procedures

6 set up to protect them against this fraud. And since the

7 bank had these systems set up and they didn't place trust in

8 Pardo, they had systems in place to protect themselves from

9 Pardo, those systems just didn't work or were circumvented.

10 And so in the case that establishes the test for

11 abuse of position of trust, the Third Circuit, itself, looked

12 at the conduct of the victim, which only makes sense, because

13 when you are trying to decide whether the person has a

14 position of, abuse of position of trust, you have to look at

15 how the victim viewed the defendant and what steps, if any,

16 the victims took to protect themselves from being defrauded.

17 Because as the commentary to the abuse of position of trust

18 enhancement say is that part of the basis for this

19 enhancement is that if the victim considers the person an

20 insider, the victim will not take steps to check up on the

21 defendant.

22 So, even the commentary to 3B1.3 says you have to

23 have some focus on the victim. And so the statements in

24 Iannone that says you don't at all look to the position and

25 the victim's action, I would submit is dicta that was not

1 crucial to the actual holding and is contrary to Pardo and,

2 in fact, basically overruled Pardo, which the panel in

3 Iannone can't do.

4 And so what I would just ask the Court to keep in

5 mind is, we are not saying Mr. Rhoades didn't do this. The

6 question is, factually, did he occupy a position of trust?

7 Obviously, he abused trust that was placed in him. You can't

8 have a fraud without the victim trusting the defendant enough

9 to give the victims' money to the defendant and then the

10 defendant take it.

11 So, there is a form of abuse of trust in any fraud.

12 You can't have fraud without it, but that is not the question

13 here. It isn't, did the county trust Mr. Rhoades to invest

14 the money properly? Of course they did. If they didn't,

15 they never would have given him the money. The offense would

16 not have happened.

17 The question is: Was Mr. Rhoades in a position as

18 an insider that prevented the county from checking up on him

19 and having any supervision? And that's just not the case

20 under the facts here.

21 THE COURT: Thank you. Mr. Piccinini.

22 MR. PICCININI: Thank you, Your Honor.

23 In this case, Mr. Rhoades' position of trust isn't

24 established for the Court by these documents that we put into

25 evidence, the documents, claims that he's an agent for the

1 investor holding monies with a custodian. That doesn't

2 establish his position.

3 He established his position over a long term, since

4 1997 and before, established himself in a position of trust

5 as the trust and investment advisor for the county and school

6 district. You can't disregard the history that this man

7 established prior to accepting the position into which he

8 was.

9 In 1997, these folks, who were the victims, are

10 getting letters from Mellon Bank, of all places, confirming

11 that Mr. Rhoades, this vice president of this trust company,

12 is the guy to turn to for their four and a half million

13 dollar certificate of deposit investment. He is the guy.

14 They established a track history, successfully

15 invest. Mr. Rhoades continues to persuade them that I am the

16 guy. And then what does he do during the period of our

17 fraud? He hangs out his own shingle. He holds the position

18 of trust as the investment advisor for the county and the

19 school district, and all these documents did for Mr. Rhoades

20 was to legitimize his position.

21 I understand the civil suit, you know, we come into

22 a criminal sentencing, we have an attachment to the response,

23 a civil litigation, an entire civil complaint which,

24 concededly by every one, has a different focus than our focus

25 here today.

1        And our focus here today is to whether to sentence  
2 this man more severely because of the position of trust that  
3 he established for himself, not who is going to have to pay  
4 money as a result. Because as we showed you from the chart,  
5 most of the \$975,000 that this man stole is gone. But, that  
6 is not our focus today.

7        We are concerned about whether this man held a  
8 position of trust. And if you actually look at the Pardo  
9 case and Iannone, it is not just as counsel indicated. Pardo  
10 makes it very clear that what we are looking at is the  
11 primary trait to distinguish a person in a position of trust  
12 from one who is not is the extent to which the position  
13 provides the freedom to commit a difficult-to-detect fraud.

14        This man had all the freedom. By all the documents  
15 that he established with the bank and by all of his long  
16 track history with these investors, he established for  
17 himself a position of trust.

18        The position that he held of trust isn't a position  
19 of trust with the bank. It's not a position of trust with

20 the auditors. We look at his victims. Did he hold a

21 position of trust with these victims? And he did.

22 We spent most of the day talking about auditing  
23 principles. And I asked Mr. Rollage one question at the end,  
24 that can't you tell, from your review of this case, that, for  
25 some reason, these victims and these auditors sent

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1 confirmation documents to this man. Yes. He said he  
2 wouldn't have done it himself but, yes, this is the reason  
3 that that happened.

4 And the answer to that question is that because  
5 this man held a position of trust and he abused it. He duped  
6 a whole lot of people. We focus on the victim, not on  
7 whether they exercised due diligence on whether he executed  
8 the fraud. Why isn't it that this fraud wasn't detected  
9 sooner? Why didn't they discover that these were phony  
10 investments because we could have figured that out?

11 The answer to that question is the same one,  
12 because this man held a position of trust and abused it,  
13 several years of that, and I believe that the two-level  
14 enhancement should apply.

15 THE COURT: Thanks. I think, no question in my  
16 mind that Mr. Rhoades did hold a position of trust. The  
17 Pardo -- Well, first of all, the guidelines give a pretty  
18 good definition.

19 Public or private -- and I am referring to Section  
20 3B1.3 of the guidelines. Public or private trust refers to a  
21 position of public or private trust characterized by  
22 professional or managerial discretion. Certainly he had  
23 that.

24 Substantial discretionary judgment. He had that.  
25 That is ordinarily given considerable deference. Persons

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1 holding such positions ordinarily are subject to  
2 significantly less supervision than employees whose  
3 responsibilities are primarily nondiscretionary in nature.

4 And certainly Mr. Rollage was a good witness and  
5 probably or might be in the lawsuit if -- that Venango County  
6 has, which I think it does include the accountants, but  
7 certainly here we don't look at the failure of the  
8 accountants to do what Mr. Rollage says they should have

9 done. We look at the position that Mr. Rhoades held.

10 The Pardo case gives us three prongs to consider.

11 First, the Court looks to whether the position

12 allows the defendant to commit a difficult to detect -- the,

13 quote, difficult-to-detect wrong. And I think, while

14 Mr. Rollage would contend that this wrong was easy to detect,

15 the history of the case tells us that it certainly was not.

16 Secondly, we are told to consider the degree of

17 authority which the position vests in the defendant vis-a-vis

18 the object of the wrongful act. And he certainly had that.

19 And, finally, we look to whether there has been

20 reliance on the integrity of the person occupying the

21 position. And there certainly was that.

22 The citation for Pardo is United States against

23 Pardo, 25 F.3d 1187, at the Third Circuit, 1994. And the

24 Iannone case said the first part of the prong is that the

25 difficult-to-detect wrong, said that the focus is on the

1 defendant, not his victims, and requires the Court to

2 determine whether the position the defendant occupied allowed

3 him to commit a difficult-to-detect wrong.

4        And so we, as I say, we conclude there is no doubt

5    in the Court's mind here that Mr. Rhoades did occupy a

6    position of trust and that he violated that trust.

7        So, there are one other minor objections to the

8    presentence report regarding some family names and I think

9    the Probation Officer has agreed to note that change in

10   his -- or amendment to his presentence report.

11       So, we find here that the offense level is

12   twenty-one. The criminal history category is Roman numeral

13   I. The applicable guideline range -- I guess we should say

14   the advisory guideline range these days -- is 37 to 46 months

15   of imprisonment, supervised release of two to three years on

16   each of Counts 6, 8 and 24, a fine in the range of 7,500 to

17   \$75,000, restitution in the amount of \$1,698,000, and a

18   special assessment of \$300.00.

19       At this time, Mr. Patton, is there anything you

20   would wish to say with respect to the sentence?

21       MR. PATTON: Your Honor, as we have set out in

22   the -- our position with respect to sentencing factors,

23   Mr. Rhoades has accepted responsibility for his offense. And

24   Your Honor is going to sentence him to a term of imprisonment

25 today so he is going to be punished in that way. And when he

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1 comes out of his term of imprisonment, he is not going to be  
2 able to go back to the profession that, for a good portion of  
3 his life, he earned an honest living on.

4 Now, when he got in trouble, in the late, you know,  
5 '90's and 2000, the legitimate investing that he was doing  
6 went bad so he is not going to be able to support himself  
7 that way. He has no money, no assets, and with his age, his  
8 employment opportunities are going to be limited, especially  
9 when he is going to have a felony conviction, and he  
10 certainly isn't going to be able to get any job that involves  
11 him handling sums of money. And so he is going to pay for  
12 this offense for the rest of his life.

13 And when you are deciding on a term of imprisonment  
14 in this case and trying to decide what is sufficient but not  
15 greater than necessary to comply with the sentencing purposes  
16 laid out in 18 U.S. Code, Section 3553(a)(2), I think you can  
17 keep that in mind.

18 As far as to reflect the seriousness of the offense  
19 and to promote respect to the law and to provide just

20 punishment for the offense, the term of imprisonment is going

21 to do that.

22 To afford adequate deterrence to criminal conduct,

23 I would submit that there is not a high degree of risk that

24 Mr. Rhoades is going to re-offend, he is not going to be in a

25 position to really commit an offense like this in the future.

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1 And sending Mr. Rhoades or having -- sentencing him to a term

2 of imprisonment will deter other people that are considering

3 engaging in this type of fraudulent conduct from engaging in

4 that conduct.

5 And while Mr. Rhoades doesn't -- there aren't

6 really needed educational or vocational training or medical

7 care that he particularly needs in this case, once he is

8 released from his term of imprisonment, he will find a job

9 and he will make payments towards restitution. And the

10 quicker he is out, the quicker he can make those payments.

11 And Mr. Rhoades would like to make a statement to

12 Your Honor.

13 THE COURT: Mr. Rhoades.

14 THE DEFENDANT: Thank you, Your Honor. I want to

15 take this opportunity to publicly state that I know how

16 terribly wrong my actions have been. I humbly apologize to

17 all the citizens of the County of Venango and the

18 Northwestern School District for the financial loss I caused.

19 In addition, I want to apologize to the officials

20 of the county and the school district and others for the

21 financial, psychological and emotional damage I caused you

22 personally. It is my sincere hope that one day I will be

23 able to pay at least the financial debt that I owe to all of

24 you.

25 THE COURT: Thank you. Mr. Piccinini.

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1 MR. PICCININI: Thank you, Your Honor.

2 On behalf of the victims in this case who, both

3 Susan Smith and Paul Steger from the Northwestern School

4 District, and victims that have shown a significant interest

5 in what happens here today, and for good reason. And I think

6 if you -- one of the things that is not considered in the

7 guidelines is the nature of our victims.

8 And I think it is important, as you decide where to

9 sentence the defendant here today, to take in the seriousness

10 by which a sentence for someone who seeks out and targets

11 victims such as these should be sentenced.

12 And, first of all, with regard to the county, and

13 we are talking about Venango County, Pennsylvania, likely a

14 financially-strapped county that has no room for the loss of

15 funds to this degree -- not that any county would -- but, in

16 particular, Venango County. And if you look at the impact it

17 has on the citizens of Venango County in the victim impact

18 statements, they talk about directly because of what this man

19 did, they have had to cancel future plans and goals for which

20 the stolen funds were earmarked.

21 They are required to divert funds to other

22 locations during current times of decreasing revenues and

23 increasing operational costs. They had to allocate

24 additional county funds from an already-tight budget to deal

25 with the aftermath of what Mr. Rhoades did.

1 And then, just from a personal standpoint for

2 members of the county, there are a lot of good people there,

3 Judge, who have been pulled down because of what Mr. Rhoades

4 did far beyond the theft of the money. They have all been

5 scrutinized and criticized and critiqued for what they should

6 have done.

7 And in the end, our focus today is on this man

8 today. I am worried about who should be held criminally

9 responsible and how they should be punished for the things

10 that they did. It's taken down the reputation of a lot of

11 good people that work down there; not just taking money. Any

12 flickers of hope that the county has of pursuing aggressive

13 idea and goals for improving Venango County are on hold

14 because this amount of money for them is significant.

15 But, if this victim isn't bad enough, you look at

16 the Northwestern School District here in Albion,

17 Pennsylvania, and what was the money earmarked for that this

18 man stole?

19 First of all, what they were doing was taking

20 interest generated from the investment of these funds

21 earmarked for improvement of facilities and programs for

22 students. They don't have the cash for that directly because

23 of what this man did. And there are other projects for --

24 their technology and agricultural program out in Albion,

25 Pennsylvania, that have to be cancelled or postponed because

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1 of what he did.

2 Then you look at the taxpayers whose money it was  
3 that he stole and how, in times of the desires not for tax  
4 increases, and everything else, you got a defendant that's  
5 stealing the money from them.

6 And then you look, Judge, at the chart that we  
7 provided to you look at what the man did with the money.  
8 There is nothing to show for it. \$975,000 over a short  
9 period of time. Judge, it is gone. Nothing to show for it.

10 And, you know, Judge, as Mr. Patton says, that this  
11 sentence in this range would be sufficient to show others  
12 that are inclined to commit this behavior not to do so, but  
13 the Court needs to wonder about that.

14 There are people in this community who would say  
15 stealing a couple million dollars and getting a sentence of  
16 37 to 46 months doesn't sound so bad a thing. Those are  
17 people that never spent a day in jail obviously and are not  
18 going to be subject to the sensitivities.

19 But, the guidelines for this man, 37 to 46 months,

20 having stolen almost two million dollars from these victims,

21 look at where, within that range to sentence him to make it

22 appear to others who were inclined to do the same thing,

23 would be severe enough from them doing it themselves.

24 That is all I have. Thank you.

25 THE COURT: Well, I think it's been well said by

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1 everyone here as to what the impact of this activity has been

2 with respect to Venango County and the Northwestern School

3 District. I am not going to belabor the point any further.

4 Mr. Patton, is there any reason sentence should not

5 be imposed at this time?

6 MR. PATTON: No.

7 THE COURT: Mr. Rhoades?

8 THE DEFENDANT: No, sir.

9 THE COURT: Mr. Piccinini?

10 MR. PICCININI: No, Your Honor.

11 THE COURT: After consulting the Sentencing

12 Guidelines, it is the judgment of the Court that the

13 defendant, Gary Dean Rhoades, is hereby committed to the

14 custody of the Bureau of Prisons to be imprisoned for a term

15 of 46 months on each of Counts 6, 8 and 24, to be served

16 concurrently.

17 It is further ordered that the defendant shall make

18 restitution to the following victims in the following

19 amounts:

20 Venango County, Pennsylvania, \$1,500,000.

21 Northwestern School District, \$198,000.

22 Any payment made that is not payment in full shall

23 be divided proportionately among the persons named. The

24 defendant shall make restitution payments from any wages he

25 may earn in prison in accordance with the Bureau of Prison's

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1 Financial Responsibility Program through which 50 percent of

2 the defendant's salary shall be applied to restitution. Any

3 restitution balance that is not paid in full at the time that

4 the defendant is released from prison shall become a

5 condition of supervision.

6 The Court finds that the defendant does not have

7 the ability to pay interest on the restitution and,

8 therefore, we will waive the interest requirement in this

9 case.

10 The defendant shall notify the United States

11 Attorney for this district within thirty days of any change

12 of mailing or residence address that occurs while any portion

13 of the restitution remains unpaid.

14 Upon release from imprisonment, the defendant shall

15 be placed on supervised release for a term of three years.

16 This term consists of three years on each of Counts 6, 8 and

17 24. All such terms to run concurrently.

18 Within seventy-two hours of release from the

19 custody of the Bureau of Prisons, the defendant shall report

20 in person to the Probation Office in the district to which he

21 is released.

22 While on supervised release, the defendant shall

23 not commit another federal, state or local crime, he shall

24 comply with the standard conditions that have been

25 recommended by the Sentencing Commission and adopted by this

1 Court, and shall also comply with the following additional

2 conditions:

3 The defendant shall not illegally possess a

4 controlled substance.

5 The defendant shall not possess a firearm or

6 destructive device.

7 The defendant shall pay any remaining restitution

8 balance through monthly installments of not less than ten

9 percent of his gross monthly income.

10 The defendant shall provide the Probation Officer

11 with access to any requested financial information.

12 The defendant shall not incur any new credit

13 charges or open additional lines of credit without the

14 approval of the Probation Officer.

15 The periodic drug testing mandated by the Violent

16 Crime Control and Law Enforcement Act of 1994 is hereby

17 suspended. The Court finds that this offense is not drug

18 related, and this defendant has no current or past history of

19 substance abuse.

20 It is further ordered that the defendant shall pay

21 to the United States a special assessment of \$300.00, which

22 shall be paid to the U.S. District Court Clerk forthwith.

23 The Court finds that the defendant does not have

24 the ability to pay a fine. The Court will waive the fine in

25 this case.

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1 We believe that a term of 46 months imprisonment  
2 followed by a period of three years of supervised release  
3 does adequately address the sentencing objectives of  
4 individual and general deterrence and punishment, as well as  
5 protection of the community.

6 Mr. Rhoades, you have a right to appeal. An appeal  
7 must be filed within ten days. You are entitled to a lawyer  
8 at every stage of the proceedings. If you cannot afford an  
9 attorney, one will be provided for you without charge.

10 I believe we have some counts to dismiss here,

11 Mr. Piccinini?

12 MR. PICCININI: Yes, Your Honor. The remaining  
13 counts that --

14 THE COURT: I think that is one through five, seven  
15 and nine -- one through five, seven, and nine through  
16 twenty-three, and twenty-five through twenty-nine are  
17 dismissed.

18 I assume Mr. Rhoades is a good candidate to

19 self-report to wherever he is assigned by the Bureau of

20 Prisons.

21 And, Mr. Rhoades, if I have your word that you will

22 show up where they tell you to show you, why, I will permit

23 you to remain on bond until such time as you receive your

24 assignment.

25 THE DEFENDANT: Thank you, Your Honor.

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1 MR. PATTON: Your Honor, I could, within the next

2 day, talk with Mr. Rhoades about a potential recommendation

3 to the Bureau of Prisons for a facility to be housed. I need

4 to talk with him some about where different relatives are

5 going to be living.

6 THE COURT: I will hold off signing the commitment

7 order until such time as I hear from you.

8 MR. PATTON: Thank you, Your Honor.

9 MR. PICCININI: Thank you, Your Honor.

10 (Court recessed on Tuesday, June 21, 2005, at 12:15 p.m.)

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12 \* \* \* \* \*

13 I certify that the foregoing is a correct transcript

14 from the record of proceedings in the above-entitled matter.

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S\Michael D. Powers  
17 Official Reporter

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